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ABSTRACT

The transcript of a hearing before the Senate Committee on Finance concerning tax incentives for education is presented. The statements of committee members and public witnesses testimony, both oral and written, are provided, as well as letters of support. Current tax expenditures for financial aid to college students, including student loan programs, are discussed, as are the rising costs of college tuition and the difficulties students and their families have in meeting these costs. A variety of tax incentives to cover college costs are also discussed, including savings account and savings bond programs and the continuation of the tax deduction for employer-paid educational expenses. A summary of the proposed tax incentives currently before Congress is provided, as are the provisions of current laws and an appendix on the background of direct aid to students for postsecondary education. (KM)

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S. Hrg. 100-723

TAX INCENTIVES FOR EDUCATION

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

MARCH 15, 1988

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

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TAX INCENTIVES FOR EDUCATION

TUESDAY, MARCH 15, 1988

U.S. Senate,
Committee on Finance,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m. in room SD-215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (chairman) presiding.

Present: Senators Bentsen, Moynihan, Baucus, Bradley, Mitchell, Riegle, Rockefeller, Daschle, Packwood, Danforth, Chafee, Heinz, Wallop, and Durenberger.

[Committee Press release No. H-6]

Bentsen Announces Finance Committee Hearing on Tax Incentives for Education

Washington, D.C.—Senator Lloyd Bentsen (D-Texas), Chairman, announced Tuesday that the Senate Finance Committee will hold a hearing on tax incentives for education.

The hearing is scheduled for Tuesday, March 15, 1988 at 10 a.m. in Room SD-215 of the Dirksen Senate Office Building.

Bentsen said, "The global challenges America faces to improve our competitive edge in the years ahead are immense. Many legislative proposals have been introduced that would provide tax incentives to expand opportunities to educate our workforce of the future. It is important that we consider carefully every means available to the Congress to encourage greater investment in our people. This hearing is intended to help us do that."

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM THE STATE OF TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The **Chairman**. This hearing will come to order. If you will, please, be seated and cease conversation.

Today, America faces growing uncertainty about its ability to compete. The world economy is more interdependent than ever before. If we are going to continue to compete we have to have a competitive education. There is no uncertainty in my mind that if you put American workers up against other workers of the world and they have a level playing field, they will come off very well. They remain hard, dedicated workers.

But if we are going to keep the standard of living up in this country and continue to improve it, then we have to improve our educational standards

Education remains the key to our nation's future economic prosperity. The educational opportunities available to future generations are going to determine the strength of our economy and ultimately whether our nation's standard of living will rise or fall. Education has always been a priority for our country, but now it truly must be a top priority.

We are facing great uncertainty about this economy of ours. Our nation experienced a record trade deficit last year of over $171 billion. One of the most effective means to improve the competitiveness of American products is to improve the skill of our workers. A skilled labor force will have the tools to develop new products and keep our country on the cutting edge of technology.

To thrive in the twenty-first century, U.S. businesses will need more and better computer scientists, engineers, mathematicians and other specialists. Yet, according to the National Science Foundation, a declining percentage of American students are entering the fields of science and engineering. Among our chief competitors, the proportion of the labor force that is dedicated to research and development has grown rapidly in the last 20 years, while our own commitment has not increased at all

Sustained growth in U.S. productivity goes hand in hand with education. In the 1980s, U.S. productivity increases have been at historically low levels, while our trading partners have had faster productivity growth. And consequently, they are approaching U.S. standards of living.

These numbers represent an urgent warning that we need to enhance the educational levels of our country. But, what we are seeing instead is that access to an affordable college education has been drifting farther away. The increase in college expenses for the 1978-88 academic year for private four-year colleges averaged 8 percent. Similar increases were recorded for public colleges. Now, that's the seventh straight year that college costs have outpaced inflation. We have now reached the age of the $75,000 bachelors degree at some of our nation's most prestigious schools. That is a 50-percent increase in only five years.

Federal support for higher education has not kept pace. Taking inflation into account, Federal expenditures for student aid have increased by only 3 percent since 1980, according to the Office of Management and Budget. That has forced families to rely more on their personal savings and on borrowing to fund college educations. Yet, the national savings rate last year dropped to 3.8 percent. And that is our lowest rate of personal saving, as a percent of disposable income, in 40 years.

Those factors make it harder and harder for students and their families to afford a college education. That does not bode well for the future direction of our economy. We have to try to find ways to turn that around.

The Federal Tax Code currently contains a number of provisions to promote education, but they may not be enough. That's why we have assembled a panel of experts today to discuss the track record of Federal Tax expenditures. We also are going to hear testimony on several new proposals to promote educational savings, including an educational savings bond program.

I have long spoken out on how we must increase the nation's savings rate to help reduce capital costs and interest rates. That is why some of these suggestions appear attractive to me. This hearing gives us a chance to hear the pros and cons of these initiatives, and to construct a guide for setting future tax policy that enhances educational opportunity.

I would like to yield now to my distinguished colleague, the Senator from New York, Senator Moynihan.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator MOYNIHAN. Mr. Chairman, I wish to associate myself wholly with your remarks and thank you for finding time in our schedule for this hearing.

As witnesses, our colleagues are waiting to speak. Our distinguished and revered former colleague Senator Ribicoff has come from New York for this occasion.

I would make just one point of particular, which is that we have before us in the Committee S. 39, which I introduced on the first day of this Congress, which will continue Section 127 of the Internal Revenue Code, which provides that employer-paid educational expenses are not taxable up to $5,250 a year.

There is a measure of urgency about this. There are millions of persons in educational programs under this arrangement right now, but the provision in the Tax Code expired at the end of 1987. So we have to get something done in this Congress, or else we will have havoc not just with individuals but with training programs and with institutions. This is about the most directed and oriented kind of education you can get.

We are going to hear from Senator Ribicoff on this. It is at the other end of the spectrum of the $75,000 bachelors degree. The greatest number of persons involved in this kind of training, 71 percent of them, have incomes below $30,000. And they are sent by their employers to learn things that will move them along in the system. It is the most directly job-related effort you could find.

I think we have strong support. We have 39 cosponsors, nine are members of this committee, for extending it.

I don't want to keep our witnesses waiting. I thank you, Mr. Chairman, again.

The CHAIRMAN. Senator, your remarks are timely and pertinent. There is no question that particular program increases productivity in this country.

Senator Riegle.

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator RIEGLE. Thank you, Mr. Chairman.

I would like to echo the sentiment of Senator Moynihan on his last comment: I, too, think we need to move on that tax issue with respect to educational programs that companies offer to their employees.

But I also want to draw attention to the very important statement that you made, Mr. Chairman, and to the importance of these hearings today. The fact that the bachelors degree now in some colleges in our country costs as much as $75,000 for the four year period of time I think is a stunning fact. The continuing rise in college costs has created a situation where a very large number of the graduates in my State these days find that they have carryover bills, debts that they carry past graduation, anywhere from $15,000 to $30,000.

What they are finding is that, as they come out into the workforce with those very large debts to both pay the interest on and eventually to repay in total, they are not able to do a lot of other things. They are not able, for example, to acquire in many cases the money needed to make a down payment on a home.

We are seeing that these facts are interconnected to home ownership, family formation opportunities, and how these go later on down the line.

I think there are ways that we can meet this problem.

We have a distinguished panel of witnesses today, two of which are seated at the table now. My own Governor from the State of Michigan has been a leader nationally in coming forward with a State-centered plan to try to solve this problem and enable families to save over a period of years to meet these costs. I think the initiative which we are starting in Michigan is one of the most important ways in which States across the country are trying to respond in a innovative way to this very substantial problem facing our country.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Riegle.

We are very pleased to have as our two first witnesses two Senators who have long had great interest in promoting and building education in our country.

I am honored to have you, Senator Kennedy. If you would proceed, and then Senator Stafford, and we will withhold any questions until the two of you are finished.

Senator KENNEDY. I would be glad to yield to my colleague Senator Stafford. I know you follow a time-honored precedent of seniority here. Senator Stafford has been the Chairman of the Subcommittee on Education in the Labor and Human Resources Committee.

The CHAIRMAN. We would be delighted to have Senator Stafford go first.

You know, Senator, you have had a great career here in the Senate. I am not very happy with your decision to bring it to an end. We are going to miss you here. You are a wonderful colleague to work with.

STATEMENT OF HON. ROBERT STAFFORD, A U.S. SENATOR FROM THE STATE OF VERMONT

Senator STAFFORD. Thank you, Mr. Chairman and members of the Committee. You are very kind to say that. We miss you on the Environment and Public Works Committee. I can tell you we had some great years together there.

Mr. Chairman, let me begin by commending the Committee for convening today's hearing on education savings plans. As the Ranking Minority Member on the Subcommittee on Education, Arts and Humanities, I have cosponsored two bills which would encourage families to invest in education through the purchase of tuition savings bonds. It is my firm belief that the enactment of such legislation would provide a vital expansion of existing federal student financial aid programs.

The proposals before you today encourage a principle which has been lost in our current federal system of support for higher education—that principle is saving for your children's education.

The cost of a postsecondary education is skyrocketing. Consequently, the opportunity to pursue education beyond high school is moving out of reach for many of our Nation's youth. At a time when the importance of improved technological training to keep America competitive is in the forefront of the public consciousness, it is imperative that opportunities for postsecondary education expand, not diminish.

For the seventh straight year, Mr. Chairman and members of the Committee, tuition has risen faster than inflation. The projected tuition for a private school in the year 2005 is now $88,778. In 1979, the average cost of attending four years at Middlebury College (my own alma mater) was $34,900. I won't tell you the cost when I was there, except to say it was something on the order of $1,000 a year. The current estimate for four years—and that's only tuition, room and board—is $67,807. That's an increase of almost 50 percent in less than 10 years. Only the most affluent American families can afford such an investment without assistance. While increased federal commitment via increased funding for Pell Grants and Guaranteed Student Loans is part of the solution, new initiatives which encourage savings must be enacted.

Only a decade ago, grants made up 75 percent of a student aid package; loans comprised the other 25 percent. Now, 10 years later, loans make up two-thirds of the financial aid package for a student. We are coming perilously close to a time when only the wealthy will be able to attend college at the institution of their choice.

In 1965, Congress established the Guaranteed Student Loan Program. This was designed as a loan of convenience for middle income families. Since its inception over 20 years ago, the Guaranteed Student Loan has replaced the Pell Grant as the principal form of aid for lower income students. Today's GSL borrower often has an income equal to the recipients of maximum Pell Grant assistance. The consequences of these changes in GSL eligibility are evidenced by the current default crisis in the program.

Over $65 billion has been loaned to students through the Guaranteed Student Loan Program. The projected annual borrowing rate is $9 billion. In the past seven years alone student indebtedness has increased by 60 percent. That means that close to 50 percent of all graduates begin job hunting already $7,000 in debt. That estimate jumps to $9,000 for graduates of private institutions. Certainly, college graduates enter the work force at a distinct advantage in terms of future earning power. We must be careful, however, not to limit career choices by forcing students to consider only those positions which offer the highest salaries.

The proposals before you today, Mr. Chairman and members of the Committee, are all relatively simple to understand and to enact. For example, S. 1817, the Education Savings Bond Act, would permit taxpayers to transfer U.S. savings bonds to an institution of higher education or vocational school as payment for tuition and school costs. If the bond is used in this fashion the interest on the bond would be excluded from the taxpayer's gross income. Should an individual decide not to use their bond for higher education purposes, there would be no loss of money. Instead, the individual forfeits only the tax exemption that is provided with this bill.

The interest deduction is appropriately fashioned to provide the most benefit to families which need the most assistance. Starting at an adjusted gross income of $75,000, only 67 percent of the interest earned is excludable. At $125,000, the excludable interest drops to 34 percent and finally at $150,000 of income, the tax benefit is lost. I might add that the bill provides for these brackets to be indexed according to the Consumer Price Index each year.

There are several other strong points relevant to several of these bills which I feel are worth noting. First and foremost is the simplicity which I highlighted earlier. No complicated "needs test" would be required. Anyone can purchase a savings bond either individually or, in many instances, through automatic payroll deductions. Currently, over 46,000 companies offer savings bonds through payroll deduction plans, with about 6.5 million employees currently taking advantage of the program.

This leads me to a second point: encouraging the purchase of U.S. Savings Bonds. In fiscal year 1987, $10.3 billion worth of savings bonds were sold to an estimated 9 million American families. Increasing the number of savings bonds sold each year has added benefits for the Federal Treasury which we all can support. Reducing tax revenues through enactment of savings bond legislation must certainly be an important consideration for the Committee. However, these cost factors should be weighed against benefits which include a better educated work force and reduced indebtedness.

This proposal also encourages saving for the future. I grew up in an era in which saving for the future was emphasized, whether for a house or a college education. In the mind of this Senator, that is a value which our federal financial aid programs should promote, not discourage. To burden the next generation with inordinate debt is shortsighted and potentially devastating to our economic future.

Finally, a federally enacted tuition savings plan has the added benefit of portability. A federal commitment to such a plan will assure a student the right to attend an institution of choice, regardless of location. Many State savings plans which have been enacted or are under consideration limit student options. A student from Massachusetts who wishes to attend one of Vermont's fine institutions should have that opportunity, and vice versa.

A recent study found that three out of four parents who wanted their children to attend a private institution said they expected them to attend a public university because they "didn't believe they would be able to afford" the private. Historically, our federal student aid programs have guaranteed both access and choice in higher education. They are principles which we must strive to preserve if we want our institutions to retain their international preeminence

I would like to leave you with these thoughts:

A recent survey found that 74 percent of the general public favored federal tax incentives for those who save for college. In Vermont, the Higher Education Council passed a resolution endorsing a savings bond proposal enacted at the federal level. Clearly, there is national support for tuition savings legislation. I am hopeful, Mr. Chairman, that you and your committee will act swiftly to bring a bill before the full Senate for their consideration. Todays hearing marks an important step toward this goal, and I very much appreciate the opportunity to appear before you. I thank you for it, and want to express my appreciation to the Chairman of our full committee, Senator Kennedy, for allowing me to be the lead witness.

The CHAIRMAN. Thank you very much, Senator Stafford. We will withhold questions until we have heard from both of you.

[Senator Stafford's prepared statement appears in the appendix.]

The **Chairman**. We are very pleased to have the distinguished Chairman of the Labor and Human Resources Committee here. He has been in the forefront of this fight to try to help in education programs.

I am delighted to have your testimony.

STATEMENT OF HON. EDWARD M. KENNEDY, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator **Kennedy**. Thank you very much, Mr. Chairman. I particularly appreciate the chance to testify.

I welcome the support of S. 1817 of yourself, Senator Moynihan, Senator Pell, who is the current Chairman of our Education Subcommittee, Senator Stafford, who is the former Chairman of the Education Subcommittee and who has presented his views today, Senator Hatch, and 28 other Senators.

This program will be good news for many parents who hope one day to give their children a college education. Rising college costs have threatened to put a college education out of reach for many families.

And I refer, Mr. Chairman, to that chart that is up there.

ESTIMATED SAVINGS REQUIRED TO MEET COLLEGE TUITION COSTS FOR STUDENTS ENTERING COLLEGE IN 2005

[In current dollars]

Type of institution	Total tuition [1] for students entering in 1987	Total tuition [2] for students entering in 2005	Estimated [3] annual savings required	Estimated monthly savings required
Public 2-year	$1,415	$4,040	$118	$10
Public 4-year	5,945	16,969	499	42
Private 4-year	31,105	88,778	2,611	220
Selective private colleges	49,259	140,600	4,135	345

[1] College board data, tuition and fees only (assumes annual 6 percent increase).
[2] Tuition and fees only (assumes annual 6 percent increase).
[3] Present discounted value of equal deposits over 17 years.

If we look over at the column on the left, you will see the cost of a public two-year college in 1987—this is just the tuition of students. The chart also shows the costs at public four-year, the private four-year, and selective private colleges. These are based upon figures that now are available in the Department of Education and are generally accepted throughout the education community.

This extraordinary explosion of costs will be an extraordinary burden for any parent.

The next column indicates what would actually be necessary to save over the next 18 years in order to pay for such an education. And in the third column over, the chart indicates what would be necessary to save per month to be able to afford the education.

I think this chart gives some idea of the extraordinary magnitude of the problem and the burden that is going to affect millions of families in this country to educate those children who are born this year.

We have a strong and long-lasting commitment to our student aid programs to provide assistance to those least able to afford it. Indeed, the most important federal student aid program, the Pell

Grants, is named for our colleague from Rhode Island. But the Federal Government has done little for the families who are just above the eligibility line for financial aid programs.

In the past, we have used the Tax Code to help families save for retirement, pay their medical bills, and buy their homes. Our proposal will create a simple tax incentive to save for higher education with the purchase of U.S. Savings Bonds.

The idea is simple. A family buys a savings bond and uses it to pay for higher education. The interest on the bond will be permanently tax-free. To ensure that those who most need help will benefit, the tax exemption will be reduced beginning at an income of $75,000, and it will be completely phased out at $150,000.

The plan has several advantages over other proposals designed to help parents save for college. First of all, and most importantly in these uncertain times, savings bonds are safe investments, backed by the full faith and credit of the United States Government.

Second, by using a savings instrument which is already widely available, no new bureaucracies are created. Families will have easy access to the program of savings bonds, through banks, the mail, or even payroll deduction. Indeed, about three-fourths of all savings bonds at the present time are bought through payroll deduction by corporations across the country.

Third, if a child does not attend college, the bonds can be used for any other expense. All that is lost is the tax advantage.

Fourth, a child can use the bonds at any institution of higher education. They will not be restricted to a single State or college as with some current plans.

Fifth, the people who purchase savings bonds are primarily low-middle income individuals, especially minorities, and young families with children. In fact, savings bonds are savings vehicles of choice for those just outside the eligibility range of the Federal Student Aid Program. I would like to call the attention of the committee for a moment, if I could, to the second chart. This tells us who buys savings bonds.

DEMOGRAPHIC PROFILE OF SAVINGS BONDS OWNERS

[In percentage]

Characteristic	U.S. savings bonds	Savings certificates	Mutual funds	Stocks
Age: Under 49 years old or less	46	27	13	30
Children under 18 in household	26	14	6	14
Household income under $20,000	28	25	6	11
Percent nonwhite	15	8	3	6
Percent Hispanic	12	7	1	5
Education: No college	34	30	6	12

Source: Treasury Department 1983 survey.

Chart shows, for example, that 26 percent of savings bond owners have children under 18 living at home compared to just 14 percent of those owning stocks.

Look carefully at the furthest column on the left; that really is the key column. You will find that younger families, families that have children in the household under 18, and families with household incomes under $20,000 prefer savings bonds moreover, minorities that are going to face the greatest challenge in terms of education also like savings bonds very much. And for people with no college education there again, savings bonds are the preferred way to save.

So, if you are looking for a device that is simple, safe, creates no new bureaucracy, is easily transportable, that well target young people and their children, and lower middle income families, this is, I believe, the vehicle for doing so.

The Joint Tax Committee estimates that this proposal will cost $300 million a year five years after enactment, which indicates the plan is likely to be widely used and will provide a significant incentive to save for college. In addition, the cost of the proposal will be offset by lower federal borrowing costs.

This is important, Mr. Chairman. According to the Treasury, the Department saves $60 million for every billion dollars sold in savings bonds. So, if our proposal results in the sale of $5 billion of savings bonds a year, the plan will be self-financing. I think that is really a unique aspect of this program.

These are the keys: self-financing, if it is widely used, reaching the targeted groups, easily transportable, safe. Some economists dispute the idea that tax incentives encourage savings; instead, they argue the incentive only encourages taxpayers to shift from one form of savings to another. But U.S. Savings Bonds are different from other savings instruments; there is an excellent chance that families who are not saving now will do so using the safe, convenient plan. In any event, I believe this tax incentive for savings bonds is justified, because it gives a higher priority to saving for education.

Our bill has been endorsed by a large number of higher education organizations, including the American Council on Education. This is the first time that this organization has endorsed any college savings plan, and I am pleased that they support this bill.

Mr. Chairman, I would like permission to include several of the letters of support for the program as part of my statement.

In sum, our bill makes economic sense, educational sense, and common sense. Education is the nation's best hope for continued economic growth and social progress. The idea of using savings bonds for education has broad support. I look forward to working with the Committee to make it a reality in 1988.

The **Chairman**. Thank you, Senator Kennedy.

[Senator Kennedy's prepared statement and the letters on support appear in the appendix.]

The **Chairman**. Let me say to my colleagues that we have quite a number of witnesses, some very fine distinguished witnesses that will make a major contribution, and we would like to move this along. I ask that we keep a five-minute time limitation on each Senator and his questions.

Let me ask of either of you this question. When we passed the 1986 Tax Bill, the idea was to try to standardize the Code as much as we could and take out as many of the shelters as we could; as a reward for doing that, we brought down the tax rates.

We have never put a tax incentive directly aimed at education in the Code. It has been attempted a number of times but never successfully.

On the other hand, we have one of the lowest savings rates in the world, and our main competition is doing a much better job of saving, particularly some of the Asian countries; their capital costs are lower as a result of that.

How do we balance these competing demands? How do we argue that this particular program is more meritorious and deserving of tax incentives? Would either one of you comment on that?

Senator **Kennedy**. Well, Mr. Chairman, three things.

First of all, I think education as an investment in the future of the country has a special priority. That is, it is not a partisan concept, but it has a special priority. If we are not going to have an educated public, we are not going to be able to compete or maintain our institutions and so it is unique in terms of American priorities.

Second, I think we can predict that we are going to be facing a unique and potentially dangerous situation. At the rate college costs are increasing, families will not be able to afford college educations for their children. I think that is a compelling reason to look at new ways to provide incentives for saving.

But finally, and I think this is the most important—perhaps the first would be my most important reason, but this perhaps might be the most important for the Finance Committee—and that is to get this kind of an impact in terms of education, you would have to have $2 billion in direct expenditures. And although the point of tax reform was simplification and fairness and didn't have a revenue component to it, if you are looking at the general economic challenges that we are going to be facing currently and in the future, those revenues or expenditures must be examined.

Our proposal is effectively self-financing, and you would have to spend about $2 billion in expenditures to have the same impact though a direct spending program.

So I think it is really quite unique. I don't think there is probably another proposal that is so basic and imperative in terms of the future of the country, and also is self-financing, as the one that we propose.

The **Chairman**. Thank you, Senator.

Senator Stafford.

Senator **Stafford**. Mr. Chairman, I would like to associate with what Senator Kennedy has said. In looking at the overall picture of higher education, we are straining the two main ways we now help students go, the Guaranteed Student Loans and the Pell Grants. They are not going to be adequate to allow students to go to the college of their choice in the future, and we are leaving students coming out of college—as I pointed out in my opening remarks—about $7,000 in debt now, which in many cases limits their career opportunities at first, because they have got to pay that money off. And as Senator Kennedy has said, this is a self-liquidating new way of increasing savings in this country at a minimal cost. And also Senator Kennedy pointed out, education is the future of this nation. College-educated people are going to have more successful careers both financially and in terms of their personal satisfaction with what they do. So I think for minimal cost, it accomplishes a great deal of benefit for the American public and for the generations coming on after us.

The **Chairman**. Thank you.

Senator Grassley, I will call on you in a minute, after the other Committee members question Senator Stafford and Senator Kennedy. The arrival schedule is Senator Moynihan, Senator Riegle, Senator Packwood, Senator Daschle, Senator Rockefeller, and Senator Danforth.

Senator Moynihan.

Senator MOYNIHAN. Just a very quick question, Mr. Chairman. Thank you, Senators Stafford and Kennedy, for a powerful idea. To get the record clear on this, Senator Kennedy described the proposal as self-financing, and he made the point that for each billion dollars or so worth of savings bonds sold, the Treasury has a net gain of I think it is $60 million.

Senator KENNEDY. Sixty million

Senator MOYNIHAN. And this I would assume is because Savings Bonds sell at a slightly lower rate than do Treasury Bonds generally, and that this money will have to be borrowed in any near term that the Treasury will be borrowing because of a deficit situation; so it will be getting money from what are called T-Bonds or some savings bonds. And the latter costs it less and, in consequence, the mechanism takes effect. Is that the case? Could you tell us exactly?

Senator KENNEDY. It is well stated, Senator, for the reasons that you have outlined. We have consulted the Joint Tax Committee and we will be glad to make all of that information a part of the record and available to the staff, obviously.

Senator MOYNIHAN. Would you do? I think that would help.

Senator KENNEDY. Sure.

The CHAIRMAN. We would be happy to have it in the record.

[The information appears in the appendix.)

Senator KENNEDY. But you have explained it correctly and why there would be the savings.

Senator STAFFORD. Mr. Chairman, if I could comment briefly, there is some advantage to encouraging our own people to buy bonds and not having to sell that many bonds overseas somewhere, along with the educational benefits.

Senator MOYNIHAN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman. I think this proposal was a very important one, and I appreciate the care and the thought that is shown today in is presentation here.

I would like just to raise three points quickly:

First, I want to join with you, Mr. Chairman, to say that Senator Stafford, who we don't often have a chance to see before this committee and who is retiring this year, has really been an extraordinary leader here in the Senate and in our country on education and on issues of the environment. The thought of his leaving is not a happy thought, but he certainly has contributed as much over the years as anybody that served in this time in the Senate.

Second, on the issue of the debts that students carry away after college today, many of the students find that they have to go on to graduate school, because the four years takes people up to a certain skill level, but then to get an applied skill beyond that requires graduate school, and that is expensive as well. But debts in the $15,000 to $30,000 range that students are taking away, particularly those who go on and earn a Masters Degree in a field, are very common today.

Senator Kennedy, let me ask you specifically: As you know, in Michigan we have what we call the Trust Program for Higher Education, and that deals solely with tuition in terms of colleges within the State. But do you see any incompatability between your bond program here for educational savings and the kind of trust program that we are establishing in Michigan?

Senator **Kennedy**. No, I don't. I think it is an imaginative program. I think that Governor Blanchard deserves a good deal of credit for moving on that issue and in providing leadership. You know, it has been debated and discussed heavily in that State and is very popular there.

Basically, as I understand it—and I know you are going to hear from the Governor later—it is for those individuals and families that have some resources today and are able to invest them and get assurance that their children will be able to be educated in a Michigan institution.

I think that that is consistent with our savings bond proposal. You have some families who have some resources today to invest in a prepaid tuition plan like Michigan's. The ones we are basically targeting out are those who have just a few dollars a month to save. And I don't think it is inconsistent at all; I think it is an exciting program. I will look forward to hearing more as a result of the Governor's statement here before the Finance Committee. But conceptually, I think it is complementary.

Senator **Riegle**. Well, I appreciate that comment. The Michigan program deals with the issue of tuition, so there is a way over time to accumulate the prepayment of that tuition when the child reaches college age.

It seems to me that in parallel, if we were to establish this federal savings bond program for education, that would be a parallel track in which people could put money away for the room and board costs and the other costs associated with going to college. So in a sense, they could really, through the use of both programs, side by side, accomplish the goal of financing that education over the years and have it ready to go when the child reaches college age. So I think they fit together very well.

I thank you very much for your testimony.

Senator **Kennedy**. Thank you.

Senator **Stafford**. Mr. Chairman, might I thank Senator Riegle for his kind remarks earlier? And, Mr. Chairman, I would ask unanimous consent that a statement by Senator Hatch be made a part of the record.

The **Chairman**. Without objection that will be done.

Thank you.

[Senator Hatch's prepared statement appears in the appendix.]

The **Chairman**. Senator Packwood?

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM THE STATE OF OREGON

Senator **Packwood**. Whenever we get into using the Tax Code, we get into two issues: One is, does it make it more complex? Two, should we be using the Code?

What you are proposing does not make it complex at all. You are saying that basically this interest is going to be counted like a municipal bond—it won't be counted as income if you use it for the purpose that is intended. That adds nothing to the complexity of taxes. It is not unlike what Senator Ribicoff is going to testify on soon, on Employer Provided Educational Assistance. At the moment the employer provides it and pays for it, and it is not counted as income. If you want to make it complex, count it as income and make the employer withhold income and Social Security Taxes on it.

I think that you have come up with a good idea. I frankly prefer it to a tax deduction where we start down that road again of every two years deciding on a new deduction—for a worthy purpose, no question about that.

But yours has the added element of not adding complexity to it, and I think there is great merit in that.

Senator **Kennedy**. Thank you.

Senator **Stafford**. Thank you, Senator Packwood. We appreciate it.

The **Chairman**. Senator Daschle.

OPENING STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator **Daschle**. Thank you, Mr. Chairman.

I would simply share enthusiastically the comments made by Senator Packwood. I like it for simplicity. I also like it for the chart as it indicated the beneficiaries to be. I think it is important that we try to target, if we are going to target any kind of a tax-related incentive, that it be targeted as you indicated to those who need it the most.

The third thing is cost, and that appeals I think to everyone here. I think we ought to be considering cost-deferred budgets, and as we consider cost-deferred budgets, it is important to note that a dollar borrowed this year is going to cost us $13.25 in a 30-year time period. And I think it is important that we realize that. Every dollar we borrow costs $13.25 in 30 years to the United States taxpayer.

In addition to that, for costs deferred in education, it is going to cost four times that amount in the first generation alone. So, by deferring these costs, we are not getting away with anything; we are going to have to pay them sooner or later, in society or in government. And I think your bill recognizes that.

Related to costs, I would be interested in knowing whether as you asked any one of the authorities that you sought out in regard to cost, how your bill deals with regard to costs compared to the other bills, relatively speaking. Is yours the least expensive of the proposals before us today, or how does it fair in that regard?

Senator **Kennedy**. We have a chart that we could submit. It is a rather detailed one, but I would rather submit it and let them make their case; I think it is quite convincing, quite frankly, in terms of the relative advantages. It puts them side by side, and of course there is kind of an analysis on that part. Let us make that available to you; we have one here.

I will submit at least our own analysis for the staff, so that you will be able to be the judge on it, if I could.

Senator **Daschle**. We could make that part of the record, Mr. Chairman.

The **Chairman**. Yes, of course.

[The chart appears in the appendix.]

The **Chairman**. Senator Rockefeller?

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM THE STATE OF WEST VIRGINIA

Senator ROCKEFELLER. First of all I want to agree with what Don Riegle said about Senator Stafford. There are only a certain number of giants in the Senate at any given time, and Senator Stafford, your decision not to run again deprives us of one of those giants. I regret that very much. Your contributions are extraordinary. I have said that privately and publicly and will continue to.

To both of you gentlemen, perhaps a philosophical question to put you on the record in that manner: The problem of indebtedness. These days kids get out of college, they owe $10-20-30,000. I have an intern in my office right now who owes $20,000 in college loans.

It is said we don't save enough, and that's not the American habit. That is true, but it is also sometimes impossible for families to save. It is not a question of deficiency in character, it is a question of simply not having enough money.

So, in your proposal, one, I would assume that lessening the burden of debt on college students are graduates themselves is obviously one of your purposes. Second, it occurs to me that the more young people are in debt or presume themselves to be going into debt as they consider college, dosen't it also have an effect on the kinds of careers they prepare for in life? For example, isn't it less likely that somebody would want to be a teacher or a social worker or go into public service if they are at the same time faced with enormous debt? Isn't there a relationship somewhere between what people choose to do in life and the debts that they have to pay under our present system?

Senator STAFFORD. I think that is true. When a student comes out of college owing a large sum of money, he or she feels constrained to take the best-paying job without regard to what satisfaction may be derived from it. So you have made a very valid point.

Senator KENNEDY. I would just add one: You will see that in terms of medical education, for example. The overwhelming majority of young students who go to medical school by and large want to be in primary health care. And that is one of the prime needs that we have in our society. But by the time they get on through to their senior years, they are into specialties, because they have not only their college indebtedness but they have their medical school indebtedness, and medical specialities is where the real money is. And until you eventually are going to come on back and make some adjustment in terms of reimbursement for various kinds of services, you are going to continue to skew that. And no matter what we try to do, for example in the Health Committee, to try to provide further incentives to move into primary health care, it is very, very difficult, whether you are talking about getting doctors in rural areas or anywhere else.

The interesting point in medical education is that the taxpayers are paying 63 percent of it. So you get the taxpayers ending up getting the short end of it both ways—the student gets the short end of it or is burdened with it, and the taxpayers, coming from middle income families or working class families, they are the ones that need medical services. But in terms of the specialization, they are finding it increasingly difficult to get it.

So, to your point, I just gave one example; but it is replicated time in and time out in terms of areas of need.

Senator **Rockefeller**. Thank you, Mr. Chairman.

The **Chairman**. Thank you.

Senator Grassley, you may join in the question and answer period at any point, and then we will let you give your full testimony as soon as we finish this round of questioning.

Senator Danforth.

OPENING STATEMENT OF HON. JOHN C. DANFORTH, A U.S. SENATOR FROM THE STATE OF MISSOURI

Senator **Danforth**. Mr. Chairman, I appreciate your holding this hearing and calling attention to the relationship between education and the Internal Revenue Code, and I commend the three Senators who are here this morning.

Senator Kennedy, I have cosponsored Senator Dole's bill, 1662, which I think is similar to yours. I am not sure what the differences are, but if the roles are still open on yours, I would be happy to join in that as well.

Senator **Kennedy**. Well, we welcome you.

Senator **Danforth**. I think that this is really a timely thing to focus on. It is clear to me that one of the tragedies of the 1986 Tax Law was what it did to education, in a number of different ways. We really picked off everything you can do to burden education in that bill. The interest on student loans is no longer deductible. I don't understand that.

I know Senator Grassley has a bill to restore the deductibility of interest on student loans. But after the 1986 Tax Bill, if you buy a yacht and, say, make interest payments on your yacht, those interest payments are deductible. If you work your way through college, the interest payments on your student loan is not deductible. I don't understand that.

I don't understand why in 1986 we for the first time decided to tax dollars for the Pell Grants, but we did. The institutional caps on tax-free borrowing by our great research universities in this country I think is counterproductive to the future of America.

Therefore, I think, Mr. Chairman, we should consider all of these proposals. I am not sure which of the several of them do the best job. I thought some time ago that we might consider the possibility of tax credits for teachers' salaries as a non-intrusive way for us to help education. If anybody is interested in that idea, I think maybe we can reopen that.

I simply want to express my appreciation to you, Mr. Chairman, for holding the hearing.

The **Chairman**. Thank you very much.

Senator Chafee, would you like equal time?

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Senator **Chafee**. Yes, Mr. Chairman.

I feel it is unfortunate to get the financing of yachts into this situation involving education. [Laughter.]

I am for both. And I am a cosponsor of S. 1718. I want to join in expressing appreciation to you, Mr. Chairman, for holding these hearings. This is a very important matter.

We have got this problem with these youngsters going to college, qualified to go, and emerging with these tremendous debts. Every statistic shows that the cost of a college education is accelerating faster than incomes in our country. So the problem isn't getting easier, it is getting worse as we go along.

So I am not familiar with all of the other proposals, and I notice from Mr. Chapoton's testimony that the Administration has a proposal itself which I am anxious to look at. I think the difference probably is the phasing out of the nondeductibility as one goes into different tax brackets. And that of course gets more complex. But nonetheless we ought to look at it. But I am glad we are looking at this.

Also, I want to join in the tribute to Senator Stafford. He has been behind more educational measures in his years here than I guess any other individual, as well, of course, as having a very, very prominent activity and name in the whole environmental field, as you yourself know so well having served in that committee with such distinction for so many years.

So, Mr. Chairman, this is a good hearing. Again, let us just put any consideration of not yachts but boats that we are talking about, humble boats for those individuals who just don't want to clutter up the landscape with a home. [Laughter.]

So, thank you again, Mr. Chairman.

The CHAIRMAN. Senator Durenberger?

OPENING STATEMENT OF HON. DAVE DURENBERGER, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator DURENBERGER. Mr. Chairman, thank you.

I am going to associate myself with everything I have heard here today.

Right now I have four members of my family in college. Fortunately, it is only three of the four boys; but Penny is back working on her masters degree, and that is about a $9,000 a year bill.

I had to sit at breakfast last Saturday trying to explain to the one son who used good sense and decided not to go into college when he got out of high school but to go into the Marines instead, why I wasn't going to cough up the same amount of money for his education that I provided for the other kids. Unfortunately, I was left with nothing but the parable of the prodigal son to say that not everybody gets treated the same.

We must all face this. We all become experts, on this subject of education, particularly higher education. I think we reach out for as many solutions to the problem as we can.

Jack Danforth was absolutely correct in his signal vote against the Tax Bill last year. It was a signal to all of us that how we tax income in this country has a lot to do with how we feel about where that income goes and how much of it is committed to education. And, I certainly associate myself with his comments on taxing the non-tuition component of scholarships and fellowships.

The Section 127 Employer Deduction needs to be restored.

But I think in the area of inequities, Mr. Chairman, in the long term one of the things that this committee is going to have to be aware of is what I can do as a parent on a limited income. I can borrow against my savings account, which is my home. And my home, because it is situated in the Washington, D.C. area, is the constant beneficiary of inflation. In one way or another that home equity, my savings account, has educated my children.

A lot of people can't do that. In parts of your State and parts of my State, where you can't sell a home, what is the home equity worth?

So we continue to finance the yachts, and we continue to finance the second home, and we continue to finance inflation through the mortgage interest deduction and the tax deduction. We build up opportunities for some parents in some parts of the country, while deflation and the other problems associated with home equity denies other parents the same opportunities for their children.

That is why I get interested in the savings bond idea and these other ideas. But there is only so far we can go with the Tax Code. And I don't know that we can be for yachts and for education.

Until we deal with the issue of what effect the tax subsidy has across the country, so that it is helping everyone equally, I don't know that we have really done the job that we ought to do.

So I just add that to the treasury of pearls of wisdom that the Chairman is collecting here today. And I compliment you on calling these hearings.

The **Chairman**. Thank you very much.

Thank you, Senator.

We face a very basic question about whether we should use the Tax Code as an incentive to accomplish something that we think is important to our society.

I am reluctant to do that normally, and as Chairman of the Committee I don't often go on a bill; but I certainly went on this one, because I know of no higher priority for the country than the education of our children. I think that is terribly important, and I think in this instance that is a reason for an incentive. It is not a shelter as we think of shelters.

I also think you get an extra dividend here since our savings rate is so low compared to other countries. It is terribly important that we increase savings to be competitive—whether we are talking about the aptitude of our children and the education of our children or the capital to fund the investments that are necessary to increase the standard of living for our people.

So, I congratulate you.

Gentlemen, why don't we excuse you? You came early, and we appreciate it.

Senator **Kennedy**. Mr. Chairman, Senator Simon asked me to include a statement in the record.

The **Chairman**. We would be delighted to do that. I understand he is otherwise occupied today.

Senator **Kennedy**. Thank you, Mr. Chairman.

Senator **Stafford**. Thank you, Mr. Chairman.

[Senator Simon's prepared statement appears in the appendix.]

The **Chairman**. Senator Grassley.

STATEMENT OF HON. CHARLES GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Grassley**. Mr. Chairman, I thank you for holding these hearings. As the focus of my testimony, I will help you answer your question. That is, "Yes," the Tax Code should be used as an incentive in education.

I am here today appealing to this committee to correct a very serious error that I think was made in the 1986 Tax Reform Act. As a member of this committee at that time, I helped make that error. Maybe we did not realize it wasn't the right thing to do.

In the 1986 "Reform Act," Congress phased out the income tax deduction for personal interest. This action will further erode the ability of students to repay their student loans. It also changes the rules in the middle of the game. Recent college graduates took out those loans thinking that they could deduct the interest.

This repeal will affect student loan defaults, which is a very serious problem. American taxpayers are going to have to pay more than 1.6 billion this year to cover defaulted student loans.

Students tell me that they are afraid of going into debt in order to finance their college educations. Their fears will be heightened by their inability to deduct interest costs.

Mr. Chairman, I think loans are a legitimate way for the Federal Government to provide financial assistance to college students.

Those students who would benefit most from higher education, however, will be reluctant to go to school unless they can acquire outright grants. We all know that such grants are not available to very many students. Many of the proposals presented to the Finance Committee today entail tax benefits for various savings plans used to finance higher education. I endorse this concept, and I, like many of you, am a cosponsor of the bill that our colleague from Massachusetts just described as S. 1817.

More than these proposals, however, Mr. Chairman, I urge the Finance Committee to first correct the mistakes of the previous Congress. My bill S. 628, would simply restore tax deductibility for students' interest expenses on their student loans.

Allowed costs would include tuition, fees, books, supplies and equipment. It could also be applied to reasonable living expenses while away from home for primary, secondary, college and graduate level education.

Only the Finance Committee, by approving legislation to put money back in the pockets of successful students, can directly provide education incentives to America's youth. The most effective incentive goes directly to the student, such as a tax deduction.

Mr. Chairman, by taking the action to repeal tax deductibility, Congress has actually imposed a new tax on individuals seeking to better themselves through education. Congress has imposed a tax on human potential.

Restoring the tax deduction for interest on student loans would emphasize the value that we place on education. The deductibility on interest on student loans should be retained for several main reasons.

First, the interest on loans secured by residences and subsequently used for education is still deductible. This has the effect of penalizing low-income taxpayers who do not own homes, but who do dream of educating their children or themselves.

Second, by lumping education expenses with consumer expenses, Congress failed to distinguish educational investment from consumer credit. Under the 1986 Act, taxpayers will be more enjoined to save for discretionary purchases rather than to buy items on credit. Education loans, however, are not discretionary; they are a necessity. Only very privileged persons can finance higher education without relying heavily on student loans.

Third and lastly, federal aid to higher education has been reduced. As the amount of financial assistance for higher education decreases, it is especially important that Congress reduce students' costs for the assistance that is available.

I would also like to mention that legislation similar to what I just described has been introduced in the other body, H.R. 595, by Congressman Schulz, and Congressman Tauke, has the same purpose as S.628, the bill I just described to you.

I thank you and urge your immediate attention to correcting this mistake.

The **Chairman**. Senator Grassley, thank you very much for your contribution this morning. I appreciate your patience in waiting.

Are there questions of Senator Grassley?

[No response.]

The **Chairman**. If not, thank you very much.

Senator **Moynihan**. Mr. Chairman, I would like to join in thanking our friend.

The **Chairman**. Thank you very much.

[Senator Grassley's prepared statement appears in the appendix.]

The **Chairman**. I would like to now call to the witness stand Governor Blanchard, the Governor of the State of Michigan, and the Honorable Abraham Ribicoff, if you would come up at the same time.

I understand that my colleague wants the pleasure of introducing the Governor, and I'll keep that fellow Ribicoff for myself.

Senator **Riegle**. Thank you, Mr. Chairman.

First of all, let me say how pleased I am that the Governor of the State of Michigan and our former House colleague Jim Blanchard is with us this morning.

He has, in his time as the Governor of Michigan, been a pioneering force with respect to how we face these issues of higher education, the opportunity for higher education, and how families and students afford higher education, i.e., how they actually accomplish it.

We have in Michigan an educational trust program, that has been established by law and that is about to go into effect. We have been awaiting certain rulings that have to be made at the federal level, but my understanding is that those are about to be made, and they will enable that program in Michigan to go forward.

There are other States around the country that are copying the plan that we have developed in Michigan, but it really is an initiative of the Governor, and I think it is one of the most important steps forward that we see being taken throughout the country to try to meet some of the problems and challenges that we have heard about this morning.

So I am pleased that we have Governor Blanchard with us, and I think you will find his testimony this morning to be very important and interesting.

The **Chairman**. We are delighted to have you, Governor.

I would like to welcome now our former colleague Senator Ribicoff. I can't think of anyone who has had a more distinguished career in public service—a gentleman who has been Governor of his State, a Cabinet Officer, a United States Senator, the Ranking Member of this committee, and one who has contributed very much to education throughout his career and has shown a profound interest in it.

I would say to you, Senator Ribicoff, the only thing that could have added to your presence this morning is if you had brought Casey. I am delighted to have you.

Senator **Ribicoff**. Thank you.

The **Chairman**. Governor Blanchard, if you would proceed. I would defer to my colleagues, Abe, but they would go on all morning talking about you, sir.

STATEMENT OF HON. JAMES G. BLANCHARD, GOVERNOR OF THE STATE OF MICHIGAN

Governor **Blanchard**. Thank you very much, Mr. Chairman. Let me say it is a real honor to sit at the same table with Governor/Senator/Secretary Ribicoff.

I have admired you since I was a young man, and I am delighted to see that I am still a young man and you are still going strong.

I am impressed that we have had at least 12 Senators in and out of this room today to listen and talk about and think about college savings plans or, as in our case in Michigan, a unique tuition guarantee program.

We are all looking at ways to provide opportunity for our people, particularly our young people, and I think we are all looking for ways to try to help them cope with what has been a skyrocketing amount of indebtedness related to college loan programs.

It has been estimated, that the average student indebtedness for those who go to public colleges and universities is about $7,000 when they graduate. For the independents or privates it is about $12,000.

To deal with that, we devised in Michigan a couple of years ago, the first of a kind, unique and innovative tuition guarantee program, which I have summarized in the testimony. What I would like to do, if I could, is to have my testimony put in the record.

The **Chairman**. It will be, in its entirety, Governor.

Governor **Blanchard**. Then I will summarize and try to get to the point.

The **Chairman**. We would be delighted.

Governor **Blanchard**. Basically, in Michigan, we offer parents or grandparents, or churches, or whoever the purchaser is of a prepaid tuition program, an opportunity to make either a lump sum payment or installment payments which are put into a trust which is managed by the State. When the child reaches college age, he or she is guaranteed four years of tuition free at any one of our public colleges and universities. And we have a great education system, as I think you know.

If they choose to go to an independent or private college or university, or a university in some other State, the investment is portable. They don't get the full amount, obviously, because we can't control those tuitions; but they do get the average sum of what the tuition would cost at, for example, the University of Michigan or Michigan State University.

We also allow for tax deductibility on the State income tax.

Our program has been in limbo pending receipt of an IRS Ruling, which is part of the law that I signed into action last year. And if nothing else, I think your hearing, Mr. Chairman, has helped produce that Ruling. Thanks to this hearing and the strong interest of Senator Riegle, our great, great Senior Senator from Michigan, and also the cooperative spirit of the Treasury Department, we have now been advised, as of yesterday afternoon, just before this hearing, that IRS Has ruled that our program can go forward.

What they have ruled, essentially—and all we needed was for them to rule that the payments to the trust by the purchaser-donor were not taxable. They are going to rule that the income generated by the trust will be taxable, but not for the purchaser, and that allows, under our law, for this program in Michigan to go forward. So, we are delighted.

Senator, again, this hearing I think has provided a nice incentive for that Ruling to be produced, and I know that Assistant Secretary Chapoton is here—we thank him for his help.

Our plan would work very well with the types of proposals you have heard about earlier this morning. There isn't any reason why they can't work in tandem.

We have a map behind Senator Mitchell, a chart which shows how many States have either enacted a plan since the Michigan plan was enacted or are considering it. I think we have about eight States in blue that have some form of tuition or college savings plan. The ones in red are considering them. And my guess is that the ones in white will.

I urge that this committee take action to adopt one of the proposals or a variation of those which you have in front of you. It would work well with what I think the States are doing, and you could [illegible] for that.

We would like to see the income on the trust not taxable. That would make our plan more attractive, and we think a financial [illegible] would show that is a wise investment.

For example, we had Coopers and Lyburn look at the tax consequences if the buildup of the trust was taxable, and it was our estimation based on that analysis that if just 4 percent more students went to college, the earnings they generate would equal the tax expenditure in the Tax Code.

So we think it is a wise investment and that it is financially justified as well.

I should also say that we do not see the Michigan Tuition Guarantee Program as competitive with other programs. The Pell Grants, the Guaranteed Student Loan are absolutely essential. In fact in Michigan we, again, have variations of that, in which we have increased student financial assistance by 150 percent these last four years, and we have increased State aid to our colleges and universities by over 50 percent.

This plan deals with those who are able to set aside some money. That doesn't help everyone. And I think it is important to thank all of you for your strong, strong support for higher education and for student assistance programs.

Let me conclude by saying that we have a number of charts in the testimony that show the status of each State and what is going on. There is a financial analysis. There is a summary of the Michigan program. There is a chronology, a chronological history of this whole concept as it is sweeping the nation at this point.

Let me conclude by saying it deals with really three goals:

One is to allow people to provide for their children's education.

The other is to try to help cope with the mounting debt, which I think does, Senator Rockefeller, affect a student's choice as to what career they might have. It also affects perhaps pursuing graduate education. If they have a huge indebtedness, they don't want to go on to graduate education, and a lot of today's jobs require that extra training.

But the final quality of our Tuition Guarantee Program and I think the education savings programs you are considering is the one of hope.

The way we came up with this idea—and the State Treasurer Bob Bowman who is the architect of it, at my wish—was we read about Eugene Lang. We read that he had gone to his grade school in East Harlem and told sixth graders that if they studied hard and worked hard and came to school and achieved, that he would find a way to send them all to college. There was counseling and there was persistent prodding, but what has happened is that about 90 percent of these kids who now have graduated from that system are going on to school. And this is a school where the dropout rates were astronomical.

My thought was, if we could find a way, if the government, Federal or State, could find a way to offer that kind of hope to someone—their name is on a certificate: "If you work hard and study hard, your education is paid for." I think that is a tremendous instiller of hope and opportunity in our young people. And if there is anything better than one Eugene Lang, it is thousands of them; and that is the Michigan Plan.

I think that is what these other plans you are considering would do—offer hope and encouragement and opportunity for the young people of our country who haven't always had it and we know want to have it.

Thank you.

The CHAIRMAN. Governor, thank you very much. I know these are two different approaches we are looking at, but I think they are complementary to each other.

[Governor Blanchard's prepared statement appears in the appendix.]

The CHAIRMAN. We would be delighted to hear from you, Senator Ribicoff.

STATEMENT OF HON. ABRAHAM RIBICOFF, FORMER U.S. SENATOR, STATE OF CONNECTICUT, SPECIAL COUNSEL, KAYE SCHOLER, FIERMAN, HAYS & HANDLER, NEW YORK, NY

Senator RIBICOFF. Thank you very much, Mr. Chairman.

First, my appreciation for your gracious comment. I would add that, of all of the things I have done, I have had more real enjoyment out of public service, of being a member of the Finance Committee, than any other role I played in Government. You are a great committee, and you are working very hard; but I have to say that your work has only started when I consider what you face beginning next year, irrespective of who the President of the United States might be.

Mr. Chairman and Members of the Committee, I speak today on behalf of Senator Moynihan's bill S. 39, cosponsored by 35 members of the Senate, which would restore section 127 of the 1978 Tax Reform Act.

I appear today on behalf of the Morgan Bank, and I ask that a statement by Mr. Herbert Hefke, Senior Vice President and Director of Human Service Resources at the bank, be included at the end of my remarks.

The CHAIRMAN. That will be done.

Senator RIBICOFF. Mr. Chairman, the safest and most consistent political buzzwords during the current 1988 campaign for all presidential and congressional candidates are "competitiveness" and "education." Only the other day Vice President Bush said that he wanted to go down in history as the "Education President."

Competitiveness is really what Senator Moynihan's bill is all about.

Morgan's experience demonstrates that section 127 is of paramount importance to lower-paid employees, women, and minorities.

According to a nationwide study prepared by the American Society for Training and Development in 1985, 71.1 percent of participants earned less than $30,000. It is estimated that seven million workers have participated in the education assistance program under section 127. This program has been tremendously successful in providing training opportunities for workers at the lower wage scales, the very people we sought to assist when we created this program.

According to all the leading economic indicators, we have descended as a nation into an ever-deepening sea of red ink. We will not be able to stop the nation's decline toward the status of a second-rate economic power unless and until we retrieve a competitive edge over other world economic powers.

Now, I understand that section 127 has been estimated to cost $200 million a year, and I sympathize with your dilemma as you seek to find ways to retrieve a projected $200 million revenue loss. However, just the opposite is the case.

The fact of the matter is that section 127 will bring in more revenue. Employees receiving an education increase their skills, and as they increase their skills they also upgrade their jobs and salaries. These workers will more than make up the cost of their training in taxes paid under higher incomes.

Mr. Hefke's statement discusses three examples from the experience of the Morgan Bank to demonstrate this point:

A secretary who obtained her undergraduate degree through the Morgan Tuition Refund Program is now an Assistant Vice President, making twice the salary she would have made had she remained in a secretarial position.

A messenger who began participating in the Tuition Refund Program, after joining the clerical staff was appointed an officer soon after obtaining his degree, and he is now earning almost double the salary he would have earned at a normal clerical career path.

A former mail clerk who worked his way through the ranks obtained an undergraduate degree in business administration and now earns in excess of $100,000 a year as a Vice President of the bank.

Now, to assess the tax ramifications of such success stories, I asked the tax department in my law firm to analyze a hypothetical case of a clerical employee who earned between $20,000 and $24,000 during five undergraduate years 1978 to 1982, but secured new responsibilities upon graduation in 1982 and is now earning $55,000 per year.

Assuming no dependents or other income and applying the standard deduction, this employee will have paid about $13,500 in Federal Income Taxes for 1987 alone—almost $9,000 more than the taxes paid if the employee had remained in a clerical position and were now earning $29,000 a year.

Assuming this employee had received $1800 in tuition reimbursement for each of the undergraduate years, the total tax foregone by the Government over five years would have amounted to some $3,090, or only one-third of the total increased tax which the employee paid in a single year as a result of this education.

In fact, using reasonable assumptions, we calculate that over a five year period 1982 to 1987, the Federal Government would realize a 900 percent return on its initial tax investment in this employee, receiving more than $28,000 in additional taxes as a result of the employee's improved education.

Even if a reasonable interest rate were taken into account in calculating foregone revenues, the return on investment would exceed 500 percent.

Over the employee's working life, it is clear that the modest investment under Section 127 would be repaid many times over in increased taxes.

Admittedly, this is a rough-cut analysis. For some workers the projected tax revenue would be less than the example chosen; for others the tax revenues would be higher.

It is fair to assume, however, that for most workers the increased training made possible by Section 127 translates into a higher adjusted gross income and higher taxes.

When this information is taken into account, the projected losses attributed to Section 127 evaporate.

Keep in mind, also, that the lion's share of these tuition payments comes from the pockets of the employers and employees themselves, and not from city, State, or Federal budgets or taxes.

Furthermore this type of education does not carry the burden of bureaucratic overhead by governmental agencies. Ironically, if this program dies, many low income workers may be forced to forego or delay education programs because tuition assistance would become an economic burden. To the extent workers drop out of these programs, no tax revenue is generated whatsoever. More important, the opportunity is lost or delayed to enhance the competitive skills of the work force.

For these reasons I sincerely hope that you will give careful consideration to the renewal of Section 127. It is a successful program and worthy of your support. The task of keeping this country competitive is too important to allow this program to expire.

I ask unanimous consent that my entire statement be put in the record.

The **Chairman**. It will be taken into the record in its entirety.

[Senator Ribicoff's prepared statement appear in the appendix.]

The **Chairman**. That was a very helpful statement, and you pointed out our dilemma—$200 million worth of revenue, defining it, trying to decide where we balance that one off. There is no question about its being a most meritorious program, and no question in my mind over the long run, and not too long a run, that you gain it all back and more.

You have cited some very good examples of how people have been able to upgrade their talents and their capabilities and how they have reaped benefits by it. I appreciate your contribution.

Senator **Ribicoff**. Well, I realize your dilemma. And realizing it, I went to work to try to analyze it. I would say if the IRS and the Treasury had put its computer experts to work, and they could gather data on all of these seven million people who are the beneficiaries, they would see how much they would be losing in tax revenue by cutting this off.

The **Chairman**. Well, Senator, you are talking to the fellow—he is seated right back there in the row behind you, and we are going to have him up here in just a minute. I think he is tuned in, he is listening.

Governor, let me ask you about yours, because I didn't understand some of the detail.

You say that a parent is able to make a contribution to a trust fund that is administered by the State?

Governor **Blanchard**. Right.

The **Chairman**. And how does that relate to the amount? Do they make contributions over a period of time. Or as a lump sum? How is that done?

Governor **Blanchard**. We are going to begin offering these contracts within the next six weeks, now that we have the IRS Ruling. We will allow them to make a one-time lump-sum payment, or installment payments. My guess is most people will make installment payments.

The **Chairman**. How much do you anticipate the payments will be?

Governor **Blanchard**. Well, each year the payments are going to vary. We require an actuarial analysis every year, an audit every year—it is an independent board—and it will depend on what we are predicting the rate of return is on our investment, and the inflation rate, and the tuition rate.

Fortunately we have some control over the tuition because they are State universities. But it will vary, however it is done.

We estimated that for $5,000 in one lump sum you could guarantee four years free of tuition at any public college or university when your child reaches 18, if you make the $5,000 payment when they are born. Now, the installments would be somewhat different.

But we are also estimating, at least in Michigan, that when the child is 18 the cost of tuition could be $30,000.

Now, the fact that the trust will be taxable is going to raise that somewhat; although, we think we can keep the installment payments the same. We will just stretch out the payment period. And we would like to see the "inside buildup," as they call it, not taxable, because we think the rate of return is going to be far in excess of the tax expenditures—in a similar fashion to the testimony of Senator Ribicoff on what a good investment education really is.

The **Chairman**. Thank you. I have a number of other questions I am going to submit to the record for you, if I may, to save some time because we have such a full agenda this morning.

[The questions appear in the appendix.]

The **Chairman**. I would like to now turn to the distinguished Senator and colleague from New York, Senator Moynihan.

Senator **Moynihan**. Mr. Chairman, thank you.

I welcome Governor Blanchard to our hearing. What an elegant, energetic thing you are doing, and what a contrast Michigan is to Washington in these regards. All we have been doing is cutting and denying and saying no.

You mentioned Mr. Lang's visit to his former school in East Harlem. It struck me just a little how strange in a way we are, as if we have reversed times.

I went to school in East Harlem. I graduated from East Harlem High School. And college tuition was no problem for me—there was something called The City College. It was free. It had been there for a century—free. And after that there was the GI Bill and Fullbright, and a generation later we find people can't get their kids into college. I mean, what is happening to us?

But thanks to you.

Governor **Blanchard**. Senator, I think it is a problem that is being discussed by all presidential candidates, I think now in both parties, and we are all part of this. It has been a lack of investment in the future. We have been burning up resources and sending the bill to others.

Senator **Moynihan**. We are going back, not forward.

Governor **Blanchard**. One of the great achievements of governments has been to create public education and public universities and find ways both public and private to support people having expanded educational opportunities.

One of my concerns, as yours and others, has been that we are choking off that possibility for the next generation.

I think I misspoke a little earlier. I want to clarify it for the record. Eugene Lang offered to six graders a college education. He would pay for it. And in a school where dropouts averaged around 90 percent, we now see that half are going to go to college as a result of this. I want to make sure I get that right.

Senator **Moynihan**. Yes. I understand.

Governor **Blanchard**. The other thing is with regard to Michigan. While the plan I proposed initially appears to be good for those with the money to make installment payments or a lump sum payment, once we get the program up and running we are going to invite all of the major businesses and civic organizations in Michigan to adopt a class or designate recipients of these programs, so that we can make it work for those with no means, because I think if we ask General Motors to adopt a sixth grade at an inner-city school, they are going to say yes.

Senator **Moynihan**. May I comment on that point to Senator Ribicoff/Governor Ribicoff/Secretary of Health, Education and Welfare Ribicoff?

I would make the point, for the benefit of the Assistant Secretary of Treasury for Tax Policy who is sitting behind here and who is coming up to oppose legislation you have just endorsed, reversing the Administration, the last year—haven't they done enough to education?—the last year they should be against this, but you weren't here testifying on behalf of the teachers union, or you weren't before a Democratic Platform Committee Hearing, you are here for the Morgan Bank.

Senator RIBICOFF. Which is one of the most important banks in this country and the world. What is interesting: They take this program very, very seriously for their employees. They have approximately five hundred employees participating in this program. As part of their affirmative action program they go to high schools and ask kids to come and work at the Morgan Bank and they will see that they get an education. And this is the money they spend, and they are so proud—Mr. Hefke is ill, otherwise he would have been here today—but they are so proud of this program in the Morgan Bank, of their achievements. And when they see a clerk becoming a vice president at $100,000 a year from a $20,000 salary, that advancement is a thrilling thing to see.

Senator MOYNIHAN. The Morgan Bank could get anybody it wished to work for them. But they are not making money out of this, they are making careers for people. And you have come down personally to see the Chairman and me on this behalf, and Mr. Hefke would have.

What do we have to say to the people in the Treasury? Help us, Abe—help. I mean, what has gone crazy in our Capital?

Senator RIBICOFF. Well, you know, the Treasury, with all due respect, takes a very short view of things, and they don't expand their brain power—which they have—to figure out, like the tax people in our law firm would, that they weren't losing money but were making money on this, and hundreds of millions of dollars, not just losing $200 million. They are not losing anything. They would lose it the other way. By cutting off the program, there would be nothing to tax to get that $200 million.

Senator MOYNIHAN. Thank you very much. Thank God for you.

The CHAIRMAN. Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman.

I want to draw attention to the chart that former Congressman now Governor Blanchard has brought to us. It is very interesting, if you look at the chart, the way this idea has moved like wildfire across the country.

The States that are coded in blue on this chart have now enacted a form of educational trust for college expenses. And then, all of the States that are coded in red have taken it up in an active way, because they in turn are trying to develop a program of that kind that can work within their States. And only the States that are left in white are the ones, as yet, that have not taken a Statewide step.

But of course, all of the 50 States would be very interested in what we are discussing here, which is a coast-to-coast program; we are discussing here today a Federal program which would reach all of the States.

But it is significant that the States are responding, as Senator Ribicoff and Governor Blanchard have said, to really an unmet need. The States have gotten ahead of the Federal Government here, partly because I think we have been behind the curve. The Federal Government in the last few years, I think, has not fully enough recognized the scale of this problem. Now the States have moved out, as properly they should, to try to respond to it.

What we are discussing here with the Federal legislation is an effort to bring the Federal Government up to speed on a 50-State basis, so that we really address this issue.

I would like to make one other point, and that is that we obviously have a requirement in the country to tilt the balance between consumption and saving and investment. We have been for a long period of time I think tilted very heavily on the consumption side, and our economy is now substantially geared that way, about 70 percent of the activity in our economy is derived by consumption.

But by any objective measure, whether it is the trade deficit, or whether it is comparative rates of saving and investments in other countries, it is obvious that we have to adjust that balance. We have to consume somewhat less, and we have to save and invest a larger amount of what we are actually generating in the way of earnings.

We have found, I think, historically that when we create incentives to save, as we did with the IRA and as we have in certain other areas in the corporate and individual tax code areas, we have seen a surge in investment activity.

What we are talking about here is investment incentive in education, in giving families an opportunity to start on a scale of saving that is within their reach, and over a period of time through the use of hopefully a tax-free buildup of interest, whether on a Federal Bond Plan or a State Educational Trust Plan, to be able to save the money that allows their children to go on and get the advanced education that is needed in today's world economy.

If we don't tilt that balance more toward the side of saving and investment—in this case, saving and investment in education and investment in ourselves, in our own skill levels—there is no way in the world we are going to be able to meet the kind of performance standards in the future that our country just has to meet.

So I would see this hearing today, Mr. Chairman, as one of the most important things that we will have done in this Congress, to take this issue up in a focused way.

I know how strongly you feel about it for we would not have this hearing but for your leadership. And, we have people out giving the leadership in the case of Governor Blanchard in my home State of Michigan, and former Senator Ribicoff who is out doing it in the private sector. I think we have to hear what they are saying to us, and we have to act. I am hopeful that we will.

The **Chairman**. Thank you very much, Senator Riegle.

Senator Daschle.

Senator **Daschle**. Governor Blanchard, I applaud you for the foresight you have clearly demonstrated here, and I am impressed with the map. I am chagrined to see the white island up on top, but I find myself in good company as I look south, so I hope that South Dakota takes a look at this at some point in the future.

I just have one mechanical question: What happens if parents would decide some years hence, for whatever reason, that they didn't want to participate? Can one withdraw those funds?

Governor **Blanchard**. Yes, you can withdraw and get your money back.

Senator **Daschle**. Get the money back, or the money back with interest?

Governor **Blanchard**. I am not sure how we are going to do that, because of the tax ruling we are about to receive.

Senator **Daschle**. I see.

Governor **Blanchard**. I think they will get their money back with interest, and there won't be any tax because the trust will have paid the tax. But my treasurer can tell me.

[Pause.]

Governor **Blanchard**. It depends on the precise ruling from Treasury, which is imminent.

Senator **Daschle**. I was just curious about the mechanics of it. You don't have to elaborate on it.

Thank you, Mr. Chairman.

The **Chairman**. Thank you.

Senator Rockefeller.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Just a comment. I think many of those who wanted to terminate Section 127 felt that the people benefiting from it didn't financially need the assistance. Senator Ribicoff, you have been, however, saying that 90 percent of the people assisted by section 127 have incomes at a level of $50,000 or below. You also say 34 percent are minorities. Now, if one has children, an income of $50,000 or below, and high education costs, one is by no means rich. So perhaps section 127 was not being abused.

To me, the concept of continuing education is so absolutely critical. I think we greatly underestimate it in our country. I introduced legislation to fund "work place literacy" programs. My bill has been made part of the Trade Bill and the reauthorization legislation for the Elementary and Secondary Education programs. This work place literacy bill addresses what Senator Moynihan is targeting in a different but related way. I would support basic skills—that is, reading and writing—for workers in need of such remedial education.

It would help people who have jobs today but who are not able to hold on to their jobs in a year or two because technology will simply walk right past them. When it comes time to go onto more advanced work through manuals, reading, and training, these workers won't be able to because they won't have the basic reading skills—unless, that is, they get literacy and educational assistance now.

What you are talking about, I think, is complementary and just as important. Senator Moynihan's bill, proposes to support more advanced training for workers.

In West Virginia we have two universities. Both of them say that the majority of their graduate students who also work in business are in school, thanks to section 127. The incentive to employers is why they are there. They don't think they would be there without that incentive from business. So, to me, what you touch on is fundamental. We are so concentrated on educating our young people—elementary education, secondary education, getting our kids through college, finding a way to pay for our kids to get to college—but there is a whole other element which I think is embodied in not only the Workplace Literacy Bill but in Senator Moynihan's bill. It's time to provide education to people who are adult, are on the job, but who are going to fall along the wayside unless they get more advanced education.

I don't ask a question on that, but I just simply point out that I think your testimony is just right on the mark.

Senator RIBICOFF. I have shortened my testimony, but seeing Senator Riegle and yourself, I want to highlight the report of the Congressional Competitiveness Caucus, mentioned in my written statement, which cited the experience of General Motors of Michigan, where some 119,000 laid-off workers are now being retrained for careers outside of the automobile industry.

A labor spokesman pointed out that the training provided under Section 127 can sometimes spell the difference between having a job and having no job at all. For such workers, losing the tax exemption provided by Section 127 would be especially burdensome.

So, this is a big, big subject, whether you are talking about the Morgan Bank or an employee being laid off because his job is discontinued at General Motors.

Senator ROCKEFELLER. I thank the Chairman.

Senator MOYNIHAN. Senator Mitchell, I believe you have a general statement as well as questions for our distinguished panel.

OPENING STATEMENT OF HON. GEORGE J. MITCHELL, A U.S. SENATOR FROM THE STATE OF MAINE

Senator MITCHELL. Mr. Chairman, first I want to commend Governor Blanchard for the leadership he has demonstrated in this area. We in Maine learned quickly from Michigan, and we were one of the first States to follow with a similar plan. I also commend Senator Ribicoff for his effort in this area, and we are very pleased to see him back before this committee.

Mr. Chairman, I ask that a full statement, a detailed statement of mine, be introduced in the record.

Senator MOYNIHAN. Without objection.

[Senator Mitchell's prepared statement appears in the Appendix.]

Senator MITCHELL. And I would like to, if I could, comment on just one other bill that is pending, as I am the author of that bill. I have been joined by six members of this committee in legislation to facilitate the availability of funds for student loans through tax-exempt financing.

My legislation would extend current law rules permitting student loan bond authorities to earn arbitrage for a period of 18 months to cover issuance costs. It also extends these rules to supplemental bonds.

Understandably, we on this committee have an instinctive aversion to the earning of arbitrage by issues of tax-exempt bonds. The Federal tax exemption should not be an income source to issuers.

Student loan bonds present an entirely different case with respect to arbitrage. The cost of administering a student loan bond program are far higher than with other programs which have loans with much larger outstanding balances. And yet, program costs cannot be recovered from student borrowers at the time of issuance like other bonds.

Furthermore, the Federal Government has a particularly important interest in assuring the availability of funds to finance student loans to make higher education affordable. That interest is manifest in the operation of the Student Loan Program, which is designed specifically to operate with tax-exemp bonds through the Department of Education.

I urge the members of this committee to take a serious look at the issues raised by this legislation, and I hope this committee will permit arbitrage to fund administration and issuance costs of student loan bonds.

Mr. Chairman, I thank you, and I thank the Governors for their patience.

Senator **MOYNIHAN**. Thank you, Senator Mitchell.

Governors, we have just at this moment a vote on, and therefore we are going to have to disappear for a bit.

Were there some last remarks you would like to make?

I want to thank both of you, as we are deeply in your debt and admiring.

Governor Blanchard.

Governor **BLANCHARD**. I wanted to thank the members of the committee again and the chairman, Chairman Lloyd Bentsen, for scheduling this hearing, because I think it really made a big difference in getting our Michigan program approved by Treasury, and I wanted to thank our Senator Riegle for all of his help.

Senator **MOYNIHAN**. That's it, say kind words about Treasury. I mean, ever so often they do something like that. [Laughter.]

Governor **BLANCHARD**. And we do thank them. We thank them for their help and cooperation, and Senator Riegle for his leadership. But we want you to know this hearing, I think, was the final point, a milestone for us, and we appreciate that.

And I appreciate the chance to share a table with a man I have always admired.

Senator **RIBICOFF**. Thank you.

Senator **RIEGLE**. Mr. Chairman.

Senator **MOYNIHAN**. Please.

Senator **RIEGLE**. Might I just acknowledge that kind comment and say that Secretary Baker has been very helpful in the discussions here, and he should be acknowledged, as his staff should be. I would say that, as we have conducted those discussions, they have been constructive, they have been very positive, and that should be put on the record. I feel that the Treasury Secretary has been very helpful in this, and that is very important.

Senator **MOYNIHAN**. Senator Ribicoff, you have heard those familiar bells.

Senator **RIBICOFF**. You go ahead. You have other duties. Good seeing you, Pat, take care.

Senator **MOYNIHAN**. Thank you, sir.

The committee will stand in recess until the return of the Chairman, and our next witness will be the Honorable Assistant Secretary of Treasury for Tax Policy Mr. Chapoton.

[Whereupon, at 11:45 a.m., the hearing was recessed.]

AFTER RECESS

The **Chairman**. Would you please be seated and cease conversation, and we will get underway.

Our next witness is Secretary Chapoton.

We are very pleased to have you and appreciate your participation. We will have other members of the committee who will be returning from the vote. If you would, please proceed.

STATEMENT OF HON. O. DONALDSON CHAPOTON, ASSISTANT SECRETARY (TAX POLICY), DEPARTMENT OF THE TREASURY

Secretary **Chapoton**. Thank you very much, Mr. Chairman.

I have a complete statement that will be entered into the record, but I would like to make some comments about the statement and respond to some of the questions that were raised during the testimony of others.

The **Chairman**. Mr. Secretary, we will take your complete statement for the record. But if you would summarize it, and then, make your comments, we would be pleased to have them.

Secretary **Chapoton**. Thank you, sir.

Let me point out initially that from the Administration's standpoint education is a national priority. In this increasingly complex society, we think that support for education beyond the secondary level is critical—it is critical to the nation's strength and to the questions of competitiveness in our worldwide environment.

I would like to talk about the college savings bond proposal which the Administration supports and proposes as one element of our efforts in that regard. I will also comment on S. 39, which would restore Section 127 to the Code; S. 628, relating to the deduction for interest paid on student loans; and S. 2149, which would expand and make permanent the arbitrage rebate exception.

But before getting into those specific bills, let me comment in general that the President's 1989 budget already contains a number of incentives in support of education. It proposes total outlays of $9.2 billion in 1989 for higher education and an additional $2.3 billion in special tax incentives, including the savings bond proposals.

The President's 1989 budget includes more federal aid to low-income post-secondary students than has ever been available in the past. So, I think that the Administration's commitment to secondary education and education in general is clear and should be fully understood.

The most significant new item in the budget, however, is the one I referred to, the College Savings Bond Proposal. That is needed, we feel, for many of the reasons that have been suggested by other witnesses this morning.

For your information—without repeating the things that were said by other witnesses—let me point out some figures that were not mentioned. Private education costs are up almost 90 percent since 1980. Education costs at public institutions are up almost 60 percent. It now costs an average of $50,000 for a family to send a child to a private university, and more than $18,000 to send a child to a public university. We estimate that those costs will soar in just

19 years. A private university will cost $200,000 and a public university will cost $60,000. We think those costs need addressing.

In addition, a 1984 Roper poll, which was not cited this morning, showed that only half the families that expect their children to go to college or anticipate that their children will go to college have some systematic plan to save for that college education. And of those half that save, the median saving is only about $500 per year. So there is not a lot of advanced planning in the nature of savings going on.

For that reason, some sort of savings encouragement plan is necessary and desirable, and we think our College Bond proposal is a major step in that direction.

A Federal program of this sort would call attention to the need for savings. It would provide a convenient mechanism and incentive for saving for education, and it would provide valuable and urgently needed assistance to American families to finance the education costs that they will ultimately incur.

There is a growing awareness of the need for this program, as has been demonstrated by the discussion this morning and the number of bills that have been introduced in the Congress.

Let me first describe the President's college savings bond proposal, and then I will be happy to answer any questions relating to it.

It is a relatively simple program. It is similar to the one proposed by Senator Kennedy in his bill. There are some differences but they are not great.

Basically, the concept is that interest on college savings bonds would not be taxed currently, just as savings bonds generally have interest that is not taxed currently. The proceeds would be exempt from taxation on redemption of the bonds if those proceeds are used for educational purposes.

There is one difference between our plan and the one that Senator Kennedy proposed, and that is what the proceeds may be used for. Our plan is slightly broader. We contemplate that proceeds on the redemption of the bonds could, like his plan, be used for tuition, books, and other incidental costs of education. We would also include some reasonable living allowances as a proper cost to be used with these funds without incurring tax on the redemption of the bonds.

To target this program to low- and middle-income taxpayers, however, we would restrict the availability of the plan to somewhat lower income levels than Senator Kennedy's proposal. His proposal, I believe, would allow the benefit of tax free interest on the redeemed bond up to the $150,000 income level. We propose phasing out that benefit over the $60,000 to $80,000 income range. This means if your income in the year that the bonds are redeemed exceeds $80,000, you would not be eligible to receive the interest on those bonds tax free. Below $60,000 it would be fully tax exempt, and between $60,000 and $80,000, it would be partially tax exempt.

To give an example of what we are talking about, if the parents of a 2-year-old started saving and put aside $2,000 per year, they could accumulate over the next 16 years—when the child would enter college—enough money to send that child to a public institution, based on our estimate of a $60,000 cost of a public institution at that time. The total tax savings on the redemption of the bonds, for a 15-percent taxpayer, would be $6,800.

So there is a tax incentive to encourage private savings, and it would have the benefit of very little Government involvement but considerable private involvement through private savings programs. It would encourage long-range planning, and it would, we hope, encourage less reliance on other Government programs.

Senator Kennedy also made several other points I think are worth repeating about this program. It would be safe for the investor, and it would not require implementing a new bureaucracy. There could be payroll savings plans allowing this money to be put aside on a periodic basis, much as we have for Series-E Savings Bonds. This type of saving would be attractive to low-income taxpayers and, therefore, we think would attract savings by the people who need to save the most.

Let me turn now to S. 39, the proposed extension of Section 127, which has been discussed at length this morning, and try to outline for you, as Senator Moynihan properly pointed out, that our testimony suggests that we are opposed to extending Section 127. We realize that this code section has expired on several occasions and has been extended each time. We also realize there are significant benefits, and I think Senator Ribicoff certainly made an eloquent statement of the need for some sort of tax incentive for this type of education. I found his remarks very persuasive.

I also think that we all agree that tax incentives for education are justified in some circumstances, so we are not disputing that point. We hope that what this Administration is doing and proposes to do with respect to education, both tax incentives and nontax incentives, demonstrates our commitment to education.

Our concern with Section 127, though, is that it is targeted strictly to the plans that Senator Ribicoff described; the Morgan Guarantee type plans, where you can only benefit if you work for an employer and you are lucky enough to have a plan of that sort available to you. And under Section 127, to the extent that costs are incurred or an education program is established that would not otherwise be deductible, the money can be excluded.

To digress a minute, under the current law any educational costs incurred by an individual to further his existing employment, to improve his ability on his current job, are currently deductible under Section 162. So the costs we are talking about that need some attention and that need tax incentives, and which Section 127 addresses, are costs that are not to improve your skills on a current job, but to improve your ability to move to a different job, to perhaps be promoted to an entirely different job with a different employer or with that same employer. Those sorts of costs would not be deductible; but for Section 127, they would be included in income.

But to get back to the point I was making. If you are lucky enough to be with a Morgan Guaranty and you have a plan like that, and you get these educational benefits, Section 127 would say that these benefits are not taxable.

However, if you are with another bank or another company that does not have such a plan, and the employer's concept is that he will pay you a sufficient salary so that you can pay out of your own pocket for any education you need to advance yourself to a new skill level or a new job, you are paying those expenses out of after-tax earnings. You would first have to pay tax on the money, and then out of those after-tax earnings you would pay for your educational costs.

In other words, we were worried about horizontal equity and about the overall costs. But this horizontal equity point that I am making is that if we are going to have a benefit like this we should consider broadening it to people who pay their own educational costs. That would make it more equitable. We would then consider, frankly, how we are going to pay for it.

I also found Senator Ribicoff's comments that some of these plans are, in effect, self-financing very persuasive as well. But I must take issue with the analysis that concludes that there would be no cost to the Treasury.

This is the sort of problem with which this committee is familiar—it addresses it all the time—that any time there is a tax incentive that encourages conduct we like—and of course, there are many—we must address the problem of whether this conduct will generate revenues through other means.

For example, Mr. Chairman, to discuss a matter that is close to our home State if we increased the intangible drilling deduction somehow, that would undoubtedly put some workers back to work. They would receive salaries, and they would pay taxes on those salaries. So we would conclude from that that the increased tax revenues generated from those additional salaries would reduce the cost of the increased intangible drilling deduction.

The problem with that analysis—and it is not totally wrong, nor is Senator Ribicoff totally wrong in saying this education benefit will cause people to have better and higher paying jobs—is that, for revenue-estimating purposes, we generally try not to take into account changes in the Gross National Product, which these additional salary levels assume.

If we start making those sorts of assumptions, we have to do it for every type of tax incentive that we are going to consider, to make sure that we are comparing apples and apples and not apples and oranges. And once we do that, it gets very difficult to know just where to stop.

When a proposal has a significant impact on GNP, we do take that into consideration when we think it is a proper subject. But when it has a more marginal effect on GNP, we think that a better comparison can be made without including that long-term GNP impact in comparing the cost of this program with the cost of some other program, so that we can have an apples and apples type comparison.

I might make one other comment. Our study indicates slightly different figures on who is actually getting the benefit of Section 127. I think we agree generally that there are substantial benefits for low-income taxpayers; but our figures differ somewhat from what Senator Ribicoff said about the people who are actually benefiting from Section 127. And we have some quarrel with the studies he cited, but not of any great significance.

The main point is that our studies indicate that even among the participants, the ones that benefit most financially are at the higher end of the spectrum. So, the money is not going to the low-income taxpayers quite as much as we would like. But I think that is not as significant a concern from our standpoint as the horizontal equity question. But if we are going to broaden the provision, how do we pay for it?

Incidentally, our figures on extending Section 127 through S. 39 are that it would cost $275 million for fiscal year 1988, and thereafter it would cost approximately $400 million per year.

Let me touch briefly on two other matters covered in my testimony. One relates to the interest deduction on education loans that Senator Grassley supported.

We recognize the point that he made that students who took out loans in pre-tax-reform days thought they were going to get interest deductions that they are not going to get in light of tax reform. But I think that we have to accept the fact that that question has been addressed. Concern about the loss of deductibility on personal interest could be raised in a number of contexts.

The offsetting factor for students and for all others who have lost their interest deductions, quite frankly, is that they are getting the benefit of the lower tax rate on the income that will have to be earned to pay that interest. So, while some argument certainly can be made with respect to the interest deduction on student loans, we think that same argument can be made in other contexts, and we think there is an offsetting benefit from the lower tax rates. We would hesitate to see tax reform opened up because of that one factor.

Finally, the testimony addresses S. 2149 relating to the proposal to make the temporary arbitrage exception for Government Student Loan Bonds permanent.

I won't comment on that at length, other than to say that it is the Treasury Department's point of view that we ought to be very careful in extending arbitrage exceptions. We sought very hard in the 1986 Act to limit arbitrage exceptions, and we think that concept should be continued.

With respect to student loan bonds in particular, under the terms of the student loan bond provisions the lenders are entitled to regain some of their initial offering costs through increased rates on loans that are made to students. So, they do recoup their initial cost—admittedly not in the first year but they do ultimately recoup the cost.

If you couple that with an arbitrage rebate exception, it would be double counting; you would get that exception twice.

The data we have indicate that many of the lenders making Guaranteed Student Loans are not short on cash and that there is not a dire need for any sort of exception. Particularly where it is an arbitrage rebate type of exception, we would be strongly opposed to it.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions.

Senator MOYNIHAN. We thank you, Mr. Secretary. We don't always envy you your tasks. You have to come forward and say No to a lot of things which perhaps you personally might want to say Yes to.

May I say—I am speaking now for Senator Packwood a well as myself. In the way chores are distributed around our committee, the Section 127 has been of particular interest to Senator Packwood, and I was a counterpart on this side of the committee.

It is the case that the Treasury has reversed itself, is it not, in the sense that in Treasury II you supported the continuation of S. 127? But don't make me assert that; why don't you tell me how that evolved.

Secretary CHAPOTON. You are entirely correct. I am not disagreeing with that at all, and I am not sure that I can give a complete explanation of that reversal. I think I can say that Treasury II represented a package proposal that had some items in it that perhaps we would have supported or not supported had it not been such a package.

Before Treasury II, we had opposed the extension of Section 127, and I think we have been consistent about that subsequent to Treasury II. But you are entirely right, there is that inconsistency in our position.

Senator MOYNIHAN. It is very fair and very open of you to put it that way.

May I just say, I think it is the case that in 1984, I believe, we began to ask employers to file some information about these plans with their returns; but we just don't really have a lot of hard data yet. There have been some problems with the data, as I understand.

Secretary CHAPOTON. We don't have the data from the 1984 filings. The data that we have gained from that have not been useful.

Senator MOYNIHAN. Yes

Secretary CHAPOTON. Now, the Treasury is engaged in a study of the Section 127-type benefits, and some of the information I have cited this morning and is cited in my testimony comes from the work done on that study.

Senator MOYNIHAN. I see our distinguished colleague Senator Pell is waiting to be heard, so I am not going to prolong it; but I would like to say that the Joint Committee on Taxation has some different estimates and lower ones on what would be cost, and I would like to put this in the record.

[The information appears in the Appendix.]

Senator MOYNIHAN. I would like to just record, if I can, that a very different case can be made about the question of vertical equity, simply that higher level employees will be able to exclude employer-provided education assistance even without Section 127. Under current law, employees may exclude from income employer-provided tuition and other such expenses as long as the training is directly related to the employee's current job. This is much easier for an executive to demonstrate than it is for a bank teller. So, despite what our good friend from Treasury has said today. Section 127 removes a tax law bias by opening the income exclusion for employer-paid educational assistance to all employees.

We thank you for your testimony, sir.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Chapoton, I am trying to calculate the difference between the proposal that the Administration has, the College Savings Bonds, and S. 1817. Do you know the net cost of that difference?

In other words, looking on page 4 of your testimony, toward the bottom there, you estimate when your program gets rolling it will cost about $200 million a year. Now, do you have a cost estimate on S. 1817?

Secretary CHAPOTON. Senator Chafee, I am not sure which that is. Is that Senator Kennedy's proposal?

Senator CHAFEE. That is the Kennedy/Pell et al bill.

Secretary CHAPOTON. We haven't costed it ourselves. Senator Kennedy indicated a cost of $300 million per year, but then he indicated that that would be reduced, in his view, by the interest savings that the Treasury realizes when it borrows that money at the lower savings bond rate rather than the Treasury Bill rate that it ordinarily has to pay.

But let me make several comments on that, if I might. The $200 million figure is our figure for the fifth year. It is a growing figure, and it will continue to grow after the fifth year.

Senator CHAFEE. Oh, you mean your figure is not a constant one?

Secretary CHAPOTON. It is not a constant one. It will grow as high as, I think our estimates are, almost a billion a year in the out years, 10 or 15 years, when the program is mature, and then it will level off. But it will be a considerable number of years out before it will level off, when redemptions begin to equal bond purchases.

Senator CHAFEE. So is it fair to say that, based on that and the estimate that they have on S. 1817, as I understand it, yours would be more expensive?

Secretary CHAPOTON. No, I think his would grow as well, because both programs would grow. Any cost in the initial year is going to grow as more people buy college savings bonds, so that there is just that much more in college savings bonds outstanding, until such time as the redemption of those bonds begins to equal the annual purchases.

Senator CHAFEE. I think it would be helpful as we go along—we are not going to decide this thing tomorrow—if you folks could come up with the differences, or just come up with your predictions and the cost estimates for theirs, so we can just calculate the difference.

Secretary CHAPOTON. Senator, there are no significant differences between our proposal and Senator Kennedy's.

Senator CHAFEE. Moneywise.

Secretary CHAPOTON. Moneywise? Well, the basic proposal, as I understand that proposal, would envision the same thing; that is, if a parent buys a savings bond for his child, and that savings bond accumulates, as it currently does without any interim tax, then on redemption, if the moneys are used for schooling purposes, there is no tax on the interest earned during that period of time.

The two big differences that I see are that the permitted cost under Senator Kennedy's bill would include only tuition and books. Our proposal would actually be somewhat broader; it would include some reasonable living expenses. And then, secondly, we would phase ours out at a lower income range—this is the income of the family at the time the bonds are redeemed. We phase ours out between $60,000 and $80,000 per year. Senator Kennedy's begins phasing out at $75,000, but the phaseout continues through $150,000 of income.

Senator **Chafee**. One final quick question: What is your experience—moreso in the IRS than in your particular area—on the policing of these things?

For example, in the IRA. As you review the IRA situation, are these moneys accounted for when people draw them out? I am only using that illustration to see if indeed it is difficult to track whether these bonds when they are cashed in are used for education. Is that a compliance challenge?

Secretary **Chapoton**. I think it is a problem that would need some attention. I am not sure there is a perfect parallel to the IRA, because in the case of the IRA the only requirement is that the recipient report that money on his tax return as he would other income that he received in that year.

In this case we need to be sure that the moneys are not only taxed when received if not expended for the proper purpose, but we need to determine whether it is expended for the proper purpose. That is a detail that has not been worked out yet. There would be some compliance difficulty, but I don't think it would be insurmountable.

Senator **Chafee**. Fine.

Thank you, Mr. Chairman

Senator **Moynihan**. Thank you.

And Mr. Secretary, we thank you very much. We sometimes give you a certain amount of ribbing but you know the respect and indeed the affection in which you are held.

Senator **Chafee**. Yes, I want to join in that, Mr. Chairman. The Assistant Secretaries who come before us are always the heavies in any role played around here. You are always the naysayers. We have all got lovely programs, and you come in with the cold rain of reality and remind us that these programs cost something. And that is not a role that is always greeted with enthusiasm.

Secretary **Chapoton**. I thank you for that. I will confess that sometimes when I get real bad news from one of our economists, I threaten to make them come up here and give it to you. [Laughter.]

The **Chairman**. Thank you very much, Mr. Secretary.

[Secretary Chapoton's prepared statement appears in the appendix.]

The **Chairman**. Senator Pell.

We are just delighted to have Senator Pell, whose name is now synonymous with education, who has been a major contributor in helping young people get a better education. We are delighted to have you here for your comments.

STATEMENT OF HON. CLAIBORNE PELL, A U.S. SENATOR FROM THE STATE OF RHODE ISLAND

Senator **Pell**. Thank you, Mr. Chairman, and thank you for your kind words. Senator Moynihan, Senator Chafee.

I am very glad to be here, and I commend and congratulate you on holding this hearing.

As you know, Senators Stafford, Kennedy and I have introduced two of the seven measures and tuition savings plans before you today.

One of these is the NEST proposal, which would establish a national education savings trust fund. For the poorest families, contributions to the fund would be tax exempt, while for others contributions would have varying rates of tax deductibility. The other measure we have introduced is the educational savings bond proposal that would allow the earned interest on U.S. savings bonds to be tax exempt if the bonds were used to finance a child's education.

I would like to speak very briefly this morning, not on the details of our two proposals or on the excellent proposal that is being offered by the General Treasurer of our State Roger Bejun, but rather on the need for a new program to help families plan for and finance a college education, a need for a generic new program.

The need is without question. In the next decade, it is estimated that the cost of college tuition will continue to skyrocket.

Unfortunately, it is unlikely that increases in student aid will keep pace. That is certainly the case with past experience. While college costs have arisen more than 75 percent, 77 percent since 1980, the values of Federal student aid has decreased.

For example, in 1980 the maximum Pell Grant award of $1750 would cover 41 percent of the average tuition bill. Today, the maximum Pell Grant covers only 29 percent of such costs, or a decrease of 12 percent.

But this does not tell the whole story. Over the past decade we have moved from a period in which the typical aid package was one-fourth loan and three-fourths grant to vice versa. And this is a very dangerous development.

Several factors have combined to bring it about: The Administration's opposition to student aid increases for much of the past seven years, although not this year, but in the past seven years, is a major factor. The two have worked hand in hand to limit the aid increases students have needed.

The sad fact is that we are creating a whole new indentured class of young people saddled with enormous debts as they start out on their professional careers.

Loans accounted for 17 percent of student aid in 1975 and 1976, and now they are almost 50 percent. This trend cannot continue. If it does, we will be pricing a college education beyond the reach of most students, even with Federal grant or work-study assistance.

We need to make sure that the Federal programs have kept place with not only inflation but also with the cost of college education.

I can't end my testimony without impressing upon all of us the urgency of the situation. The facts are really disturbing.

The number of Blacks pursuing a college education has declined from 34 percent to 26 percent in the past decade—declined. The number of Hispanics has dropped from 36 percent to 27 percent over the same period. And as I have noted earlier, even when students can find a way to go to college, they do so only through this enormous borrowing.

I am aware that any proposal of the kind before you will have a large price tag. That cost will pale, though, if we consider the long-term cost to our nation of not moving ahead this way.

In a year in which there is much discussion of the need for the United States to make its worth more competitive, we would be shortsighted if we failed to link such a concern with the availability of education programs for future generations.

The real strength of our nation is not the weapons of destruction or the machines of destruction or the gold at Fort Knox, but the strength and character and education of our people. And this, that education, is declining for those who need it the most, the Blacks and the Hispanics.

I thank you for giving me this opportunity.

The **Chairman**. Chairman Pell, we are very pleased to have you here, and I am delighted to see you focus on those who are not as well off from an economic standpoint and speak to seeing that those young people too have their shot at education and a chance for a step up in life.

I have no further questions.

Senator Moynihan.

Senator **Moynihan**. Yes, Mr. Chairman.

I just wanted to say that, as is so often the case, a graphic phrase from Senator Pell when he speaks it, "We are creating an indentured class of young people." It is extraordinary. We look up at something we thought was behind us, and it is ahead of us. We have to do something about it, and we should.

Thank you, sir.

Senator **Pell**. Thank you.

The **Chairman**. Senator Chafee.

Senator **Chafee**. I would like to join in paying tribute to Senator Pell for his long work in this area. He has, of course, been deeply interested in education for so many years and has been so effective in it. I want to express my appreciation in hearing your views today.

Senator **Pell**. Thank you for your kind words; it is very much appreciated. Thank you.

The **Chairman**. We are very pleased to have you.

We will recess until 2.

Senator **Chafee**. Mr. Chairman.

The **Chairman**. Yes.

Senator **Chafee**. Because I have an amendment coming up on the floor on the Intelligence Oversight Bill, I won't be able to be here this afternoon, but I did want to commend to your attention the testimony of the General Treasurer of our State Mr. Roger Begin, who will be testifying on the third panel—that is, the second panel after you reconvene. I am very sorry to miss his testimony.

He has got a good program that he will be testifying to, discussing a proposal that we have in our State dealing with this very problem, that he has been active in.

So I want to express to him and to you my apologies for not being able to be here.

The **Chairman**. Yes, of course.

We will stand in recess until 2.

[Whereupon, at 12:34 p.m., the hearing was recessed.]

[The prepared statement of Senator Pell appears in the appendix.]

AFTER RECESS

Senator **Moynihan**. A very good afternoon to our guests and our witnesses. I hope that the inconvenience we have caused some of you is taken as a measure of interest in the matters that are before us. It is very unusual for one of our hearings to go into the afternoon, and we have to have permission to do it, as a matter of fact, from the Senate; but we have done it.

I am aware that some of our witnesses have to catch planes, and we will go and hear everybody, and the record will be completed, but we have two panels which are more or less interchangeable in the sense that we want to hear each of the six persons.

Which of our witnesses has to be at a 3:00 plane or something such a that? Come forth.

Dr. **Hayes**. Dr. Hayes, from St. Edwards.

Senator **Moynihan**. From Austin, Texas. Yes, indeed.

Dr. **McPherson**. Michael McPherson.

Senator **Moynihan**. And Michael McPherson.

Well, there we are. And Dr. Eaton, are you here? Then come forward, and we will start with Dr. Hayes and then Dr. McPherson, just as it is provided in the program anyway.

We welcome you, Dr. Hayes. As you know, Senator Bentsen has to be elsewhere and asked me to take this on, this legislation which I have partly been the sponsor of here in the committee.

So, would you just proceed? You might wish to put your statement in the record and then summarize it for us.

STATEMENT OF DR. PATRICIA A. HAYES, PRESIDENT, ST. EDWARDS UNIVERSITY, AND CHAIR, TAX POLICY COMMITTEE, NATIONAL ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES, AUSTIN, TX

Dr. **Hayes**. Thank you very much. I would want to do that.

Mr. Chairman, thank you for the pro-active posture of this committee in trying to strengthen further the federal support for higher education.

I am representing today the National Association of Independent Colleges and Universities, a group of over 800 independent colleges and several other higher education associations that have supported this position.

My university, St. Edwards University in Austin, Texas, is a 2,700-student university with 1,400 full-time students and 1,300 part-time adults. We provide the majority of the part-time adult education in the Greater Austin area at the baccalaureate and masters level, and our 1,400 full-time undergraduates consist of 21 percent Hispanic students, about 6 percent Black, including 200 students in a special program for children of migrant farm workers.

The National Association of Independent Colleges and Universities wishes to provide the strongest partnership with congressional efforts to develop a cost-effective form of a tax incentive for educational savings, in part for the reasons that were mentioned this morning—the general economic concern with the level of savings in this nation (less than 4 percent compared to the Japanese level in similar time periods, 17 percent) and in part because of the terrific shift that was well documented this morning between student grants into student loans over the last decade.

What has really happened in this period, of course, is that families have willingly, on behalf of education, increased their burden in all of this by taking on the loans. All of the surveys suggest that they are very open to savings, but that savings has not taken place in adequate amounts.

We are certainly enthusiastic about the institutional efforts and some of the State initiatives, but we feel that a Federal Plan is far superior for a number of reasons.

I think the primary input we would like to give is in the form of five points that we feel any plan in the educational savings area ought to be measured against, some of which were stressed this morning, others I think have a slightly different emphasis:

First, simplicity. The ability to find it, access it without a lot of bureaucracy, without a lot of psychological barriers, and a certain credibility that my money is safe there and I understand that plan, it is not some kind of financial high-powered thing that makes the average person nervous.

The second issue came up repeatedly this morning: portability. And I would like to just comment on that. Portability on behalf of choice, I think, sometimes comes across as a kind of luxury, "Well, if they can get education, let them get it wherever it fits." But I think choice really boils down to what makes a given student successful in a specific institution.

It is no big mystery that first-generation Hispanic students are more attracted to St. Edwards University and more successful there at 2,700 students than they probably ever will be at the University of Texas at Austin of 48,000 students. The match is better, and their success is more guaranteed. And I think that really is what is at the heart of portability.

The third issue—actually, the distinction between the Michigan Plan and the educational savings plans that were talked about this morning has to do with the timing of the tax incentive, and we would come down in favor of timing when the educational benefits are received rather than when the money is invested. I think it is more cost-effective if at that time it is focused on tuition and fees. We think it is the best way to stretch the federal dollar.

The fourth point, an issue of accessibility, that not just parents and students but grandparents and aunts and uncles can get into this program. I think we are going to see an era when the grandparent takes on more prominence than we have ever seen, because of student loans and the burden they are putting on people into their mid-years. And we think any program that is ideal in terms of educational savings should have the broadest level of accessibility.

Finally, and something that would surround all of our testimony, is the desire that educational savings only and always be seen as a supplement to grants, work and loans, and never as a substitute. All of the data suggests that loads of families that the Pell Grant program is dedicated toward are never going to be able to save in any meaningful proportions.

So, we support an educational savings program as a supplement to all of the strong, traditional sources.

I think of the plans currently under discussion, Senate Bill 1817 is closest to those five criteria.

The other three areas that were discussed this morning, I would just mention briefly our strong support for the comments you made, Senator Moynihan, on the urgency in Senate Bill 39 and the restoration of the Employee Educational Assistance.

When you look at the students we are serving at the adult level, they are not wealthy; they are a part of an important economic revitalization that I think is part and parcel of our national competitiveness. The fact that that kind of funding goes for people moving on to a job seems to me is much more oriented to the future when we estimate that students will be taking on four or five career changes after they graduate.

I think the negative message that has gone out every time Section 127 has lapsed is certainly a disincentive to students, but it is also a disincentive to that source of private capital which helps some students go to college—namely, the corporate sector.

I would reply directly, I guess, to the concern of Treasury, stated this morning and that is that there is a problem of horizontal equity with 127.

The students that don't get corporate support get great support from the institutions, again, where all data shows there are higher and higher levels of institutional aid. To take the corporate support away simply puts more burden on the institution.

So I would like to affirm those corporations that are able to give private capital to this effort in the strongest way, knowing that some will not be able to. And, again, there will have to be increasing amounts of institutional aid available.

We would also like to encourage Senate Bill 628 to be considered seriously, the deductibility of interest on student loans. Again, those folks graduating with $10-15,000 worth of loans have sacrificed greatly on behalf of higher education, and it seem that the spirit of the Federal position on education is better supported by maintaining that part of the Tax Code that was reversed under the Tax Reform of 1986.

Lastly, a similar case where it seems that the great Federal commitment to education is being somewhat undermined by the tax revision, the taxation of fellowships and scholarships.

Thank you very much. I would certainly be happy to answer any questions on any of these issues or others.

Senator MOYNIHAN. We thank you, Dr. Hayes, and as is our practice, we will go to Dr. McPherson next.

[Dr. Hayes' prepared statement appears in the appendix.]

Senator MOYNIHAN. Dr. McPherson, welcome.

STATEMENT OF DR. MICHAEL S. McPHERSON, PH.D., CHAIRMAN, DEPARTMENT OF ECONOMICS, WILLIAMS COLLEGE, WILLIAMSTOWN, MA

Dr. MCPHERSON. Thank you, Mr. Chairman.

My name is Michael McPherson. I am the Chairman and a professor in the Economics Department at Williams College in Massachusetts.

The bills I have been invited to comment on are those that aim to encourage saving for college by providing tax preferences for that activity.

Encouraging saving is a worthy goal, but I, like many economists and like Senator Bentsen this morning, have serious reservations about using tax preferences to achieve that goal.

In my view, the reduction in tax preferences accomplished through the 1986 tax reform was a great achievement, and I am pleased that this committee is scrutinizing proposals for new preferences with suitable care.

Let me note that there are alternatives to using tax preferences to encourage planning and saving for college, although I realize that these alternatives would not fall under the jurisdiction of this committee.

These alternatives include expanded funding for grant programs, with reforms in the programs that would encourage parental investment in education, as well as the possibility of direct federal expenditure programs which would match family savings in some proportion.

Having noted those, however, let me turn to comment on the bills that are before this committee. The bills differ in three main ways that I want to comment on:

First, some of the bills limit benefits according to family income while others do not. No social purpose, I think, is served by providing tax benefits to affluent families who can and do readily put aside money for college without such help. It is also true that bills that lack any kind of income limitation are considerably more costly, since we know that people with relatively high incomes are more likely to take advantage of tax-preferred savings instruments.

Second, some of the bills are much more expensive in tax costs than others. Bills that both exclude contributions to educational savings accounts from tax and also permit tax-free distribution from those accounts are providing quite generous tax benefits; in fact, probably something like three or four times as generous as the treatment that was until recently accorded to IRAs in the Tax Code.

Finally, some of the bills are administratively much more complicated than others. The creation of new financial institutions or new financial instruments, or of new kinds of trust agreements for banks to administer, seems to me something that should be avoided, if possible.

In sum, I would urge that if the committee advocates any tax preference for savings, any program it supports should be kept modest in cost, simple in operation, understandable to the public, and limited to families of modest means.

Among the bills before you, S. 1817, sponsored by Senators Kennedy, Pell and Stafford, as well as by several members of this committee, seems to me to come closest to meeting these criteria.

I must say that I would be still happier with the bill if its income ceiling, which is currently at $150,000, were reduced to something like half or two-thirds of that value.

Let me further urge that the Senate take note of the flurry of activity at the State level aimed at development of college saving and tuition prepayment plans which might qualify for favorable

Federal tax treatment. Governor Blanchard of Michigan talked about one of those plans earlier today.

Rather than, as currently, leaving it to the States to design ingenious plans with the hope of a favorable IRS ruling, it would seem to me more desirable that Congress should pass legislation that makes clear just which kinds of State or private plans, if any, deserve that kind of favorable tax treatment.

I would underline that the kinds of plans that are under consideration in many States, if they receive as favorable tax treatment as they hope for, would involve potentially quite large Federal tax expenditures. Certainly if all the States that were in red on the chart this morning turned blue, the total tax expenditure could well be higher than some of the bills you are considering at the federal level. And I believe Congress should clarify and decide explicitly what kind of plans it believes are worthy of federal subsidy.

In conclusion, let me note that getting families to plan for college in both financial and academic terms is itself to a large degree an educational task; at least as important as any financial incentives that governments may provide is the job of helping families learn to think about these issues in a longer time perspective than we have traditionally done. This is a task in which educators, community leaders, and governments at all levels can share.

Thank you.

Senator MOYNIHAN. Thank you, sir. That was a model of an economist's concision.

Dr. Eaton.

[Dr. McPherson's prepared statement appears in the appendix.]

STATEMENT OF DR. JUDITH EATON, PRESIDENT, COMMUNITY COLLEGE OF PHILADELPHIA AND CHAIRPERSON, AMERICAN COUNCIL OF EDUCATION, PHILADELPHIA, PA

Dr. EATON. Thank you, Mr. Chairman.

I appreciate the opportunity to testify before the committee. I will focus on the Employee Educational Assistance issue, and I wish my statement to be part of the record.

Senator MOYNIHAN. That will be done.

Dr. EATON. Thank you.

My name is Judith Eaton. I am President of Community College of Philadelphia, the present Chair of the American Council on Education, past Chair of the American Association of Community and Junior Colleges. I am also testifying on behalf of the more than 200 organizations forming the Coalition for Employee Educational Assistance. Thus, I have the privilege to represent industry, labor, and education interests in educational opportunity for minorities, for low-income individuals, for part-time students, for women, for those who have been in the past educationally neglected.

The Coalition and the organizations also support the higher education community's positions on the Education Savings Act, elimination of taxation of scholarships, and restoration of deduction of interest on student loans, to which my colleagues have so ably spoken.

We talk today about the Employee Educational Assistance Program as assuring that training costs paid by employers to help employees improve job skills are not taxed as employee income. We have spent less time focusing on the need to eliminate the confusion of the Treasury Regulation 162-5, which required employees to demonstrate that educational assistance was strictly job-related. This confusion, in my mind, produces two problems:

First, employees with more limited or restrictive job descriptions are actually denied access to education.

Second, employers, because of the complicated procedures associated with the program, are discouraged from offering the program—it takes time, it takes paperwork.

Restoration of 127 would solve this difficulty. But why have the program at all? I offer three reasons: It ensures competitiveness; it is an efficient and effective means whereby we maintain the quality of our workforce, an issue of very great concern throughout the country.

Second, it encourages educational access and workers' upward mobility. Those who need training the most—the lower-paid, those with jobs not considered professional, those with jobs with little inherent growth—have opportunity for advancement and development.

Third, the Employee Educational Assistance Program encourages teaching, encourages research. Tuition remission for graduate research and training would be, once again, able to function, to provide leaders in science, technology, business, and government.

Senator Ribicoff referred to the seven million employees who have been able to benefit from this program during the past nine years. Employers have paid an estimated $70 million in tuition costs to assist these people over the years.

The Senator also referred to the 1985 survey handled by the American Society for Training and Development. The survey focused on employee educational assistance. He pointed out that 72 percent of the employees taking education and training courses earn less than $30,000 a year. If I may, I would like to add a few other points from that survey for the committee's consideration:

Ninety-seven percent of the respondents to that survey have educational assistance plans.

Senator MOYNIHAN. And that was a random sample, I assume, at the outset.

Dr. EATON. It was a survey sample, 1000 institutions public and private with a range of employees from a mere 43 to 100,000, and the response rate was about 35 percent—very, very high.

I found it extremely interesting, Mr. Chairman, that 91 percent of the respondents cited their local community college as a provider of educational assistance courses. This is especially significant, in my view, given the issue of educational equity. Those who attend community colleges are most likely to be minority, lower-income, first generation college goers. This is an unusual and important asset to their ensuring their own personal growth and development, to ensuring the opportunity for a variety of careers.

Ninety-six percent of the respondents said educational assistance was used for improving skills and performance on the job, and 54.8 percent of the respondents said educational assistance helps employees learn basic skills like reading and writing. That, too, is an issue of consideration before this committee this morning.

Thank you once again for the opportunity to address you on this important issue. I would be happy to respond to any questions you may have.

Senator **Moynihan**. Thank you.

[Dr. Eaton's prepared statement appears in the appendix.]

Senator **Moynihan**. I want to say again that, if we seem to be compressing your appearance here, it is because the people you really most need to have with you in this body, which are the fellow Senators wanted to speak basically on your behalf.

Two things. It is anecdotal and not much use in itself, but I have been struck in the last five-six-seven years at the degree to which we—it may just be an impression—but we seem to be digressing in our arrangements for higher education.

I will say again, I went to high school in East Harlem. That was free. And I graduated, in 1943 I guess, and went to City College which was free. We established City College in 1848 to provide a free education. I went in the Navy, came out of the Navy and had the G.I. Bill, and a Fullbright, and just never stopped going to college until I finally decided it was time to grow up. And the aftermath was a more than normal supply of textbooks that I accumulated along the way.

Whereas, we find young people, coming into what ought to be your good years in life—you are out of college, before you have to get married—and they spend their time—you know, the back offices of all of our Senators are filled with very able young people—thinking about how they are going to pay their debts. That time comes soon enough, when you have a car, the house, and children. But there they are. It is a mystery to me.

I have two questions here. Dr. McPherson, we will put you right in the middle, because Dr. Hayes and Dr. Eaton are both heads of institutions one in the public sector and one in the private sector.

I would like to record, while I certainly can't say it to be the firm view of this committee, that certainly we are aware that the 1986 tax legislation was not friendly to education and particularly unfriendly to private education. And Dr. Eaton and Dr. Hayes, you represent those groups.

The Treasury Department, prior to—I don't know if you know the technicalities, but it is important—prior to the 1986 legislation, the private institution like St. Edwards under our tax law was described as an "exempt person," and it had the same status under the tax law as your community college in the City of Philadelphia as in the State of Texas or Massachusetts. We stripped that away.

That old dictum of Joseph Shumpeter about what will change modern society is not some socialist upheaval but the steady conquest of the private sector by the public, if we don't restore that equality condition as, say, between Stanford and Berkley, in 30 years time you are not going to recognize Stanford, and we are going to be missing a lot of the institutions that are there now, which are a treasure, I think. Would you not agree to that? Just the steady grind of different levels of access to capital, access to financing?

Dr. **McPherson**. Well, I do agree that the 1986 tax law was hard on higher education and harder on private than on public higher education. And I think it is always a worry if you wind up in doing a number of things that individually look very sensible but add up to putting a real burden on or changing in an important way the balance between activities that you care about.

I think my view, and I suspect the view of many economists, is that in many cases the individual provisions were not such socially desirable ways of accomplishing the worthy efforts toward support of higher education, and it would be attractive to think about other ways of achieving those goals that might wreak less havoc with different aspects of the tax system.

But I do agree that if you wind up taking a chunk of support from an activity that you value, you ought to look for the best way to give support back to that activity.

Senator MOYNIHAN. I have to go and vote. You have to get back to your campuses. We have a series of questions for each of you which the staff will give you.

We thank you very much for your courtesy. We very much value your support. Don't leave us. We have big issues of educational policy to be dealt with in this committee in the next few years, and we want to stay in touch with you. We thank you for coming all the way from Texas, down from the Berkshires and from the Schuylkill.

We will stand in recess until I return from the vote. Thank you.

[The questions appear in the Appendix.]

[Whereupon, at 2:31 p.m., the hearing was recessed.]

AFTER RECESS

Senator MOYNIHAN. The committee will return to session.

I think that is our last vote for some time, so we can be assured that our remaining witnesses will have a full opportunity to have their views presented and encouraged.

This is the last of our three panels today, which of course were preceded by a whole range of Senators who wished to be heard on this matter.

So I am going to ask Mr. William L. Davis, who is the Secretary-Treasurer of the South Texas Higher Education Authority—Mr. Davis, are you in the room, sir? Good afternoon, sir—the Honorable Roger N. Begin. Mr. Begin, are you able to be here? Senator Chafee is on the floor at this very moment. Mr. Begin.

Mr. BEGIN. Yes.

Senator MOYNIHAN. Good afternoon, sir. Senator Chafee mentioned earlier, and perhaps you were in the room, that he would be calling up an amendment this afternoon and wouldn't be able to be here when you testified. He is, as a matter of fact, on the floor at this very moment.

And finally, Dr. John Finnerty, who is the Executive Vice President and Chief Financial Officer of the College Savings Bank of Princeton, New Jersey. Dr. Finnerty, we welcome you.

As is our practice, we will go according to the listing in the schedule. So, Mr. Davis, you are first.

STATEMENT OF WILLIAM L. DAVIS, SECRETARY-TREASURER, SOUTH TEXAS HIGHER EDUCATION AUTHORITY, McALLEN, TX

Mr. DAVIS. Thank you, Mr. Chairman.

My name is William L. Davis. I am Secretary-Treasurer of the Board of Directors of the South Texas Higher Education Authority, and I am here to testify on the use of tax-exempt bonds to finance student loans.

In essence, the amendment to the Tax Code that was sponsored in 1976 by Senator Bentsen to permit the issuance of student loan bonds to finance educational loans was then perceived as a local problem in South Texas. As the Senator said then, "If you are very rich and have a talented child you want to send to college, it is no problem. But for that group in the middle, if you have one, two, or three you are trying to send to college, it is tough, and a college education is slipping out of the grasp of the middle-income people of America."

In a nutshell, we found that virtually the only program available to middle-income students was the loan program authorized under the Federal Higher Education Act of 1965, under which primarily private financial institutions make educational loans. The problem was, however, that few loans were granted, and understandably so because, one, the interest rate on loans was restricted under law to a below-market rate; two, there were burdensome servicing and collection requirements imposed by program regulations; and, three, for small-balance installment type loans the term of repayment, which is up to 10 years after separation from school, substantially exceed normal bank lending practices.

The South Texas Higher Education Authority was created to address these concerns, by providing an effective secondary market for student loans. It was the first of its kind in the nation, and I am pleased to report that it has in fact accomplished what Senator Bentsen set out for it to do for South Texas.

The banks and other lending institutions of South Texas did respond to the concept, and the Authority has now supported lenders in providing financing for 25,736 students who are in attendance in more than 790 institutions of higher education.

The people of South Texas are grateful to Senator Bentsen for making that possible. But not only have the people of South Texas benefited, but because of the adoption of the Bentsen Amendment 39 States and the District of Columbia and Puerto Rico have also utilized the approach to meet this specialized need within the broader scope of educational financing.

Today the key issue is not so much whether to permit tax-exempt financing for student loans, but rather under what rules and conditions will tax-exempt financing be permitted?

From the issuer's perspective, and most likely because student loans represent such a very small part of the total tax-exempt financing picture, we operate under a structure of rules that was essentially designed to fit programs that involve either, one, the financing and utilization of physical facilities in an ongoing program, such as municipal utility facilities, but, and an essential difference, where the issuer can control program or project revenues by setting its own rate schedules; or, two, the financing of physical facilities such as industrial facilities, in which there are virtually no ongoing operations of the issuer as such.

There is a tendency to assume that student loan bond programs should be able to operate under these traditional structures. We desperately need your understanding, however, as you seek to refine and better control tax expenditure subsidies via new arbitrage and arbitrage-related rules, of some of the unique aspects of educational loan financing.

For example, under present law, after December 1988, student loan bond issuers would be required to rebate any income in excess of bond yield on non-purpose obligations earned during the co-called temporary or temporary bond use period.

One of Senator Bentsen's main points in offering his 1976 amendment was that the operation of this program doesn't require the need for any additional or special appropriations by Congress. The program fully pays its own costs out of operations, out of the difference between revenue taken in and the cost of program operations.

Student loan bond authorities were not designed to have and do not have access to sources of funds outside of direct program revenues to pay the cost of bond issuance and program operations. Although they operate under the supervisory control of State and local governmental units, they do not have taxing power, for example.

Additionally, student loan bond issuers cannot increase the interest rates charged on educational loans to recover these costs, because the interest rates on student loans are set under the Federal Higher Education Act.

We commend Senator Heinz who, in recognition of the unique characteristics of the student loan program and in support of continuing need for student loan financing in Pennsylvania and in other states, sponsored the provisions in the 1986 Tax Reform Act, which provided the exception to the new rebate rule generally applicable to other types of tax-exempt bonds.

We also commend Senator Mitchell of Maine, who has recently introduced legislation to make permanent the exception to the rebate rule, so as to permit student loan bond issuers to cover their cost of issuance and operation where necessary, and only where necessary, through retention of income earned on temporary investments during the temporary bond use period. This is a most and fundamental requirement that needs to be recognized if this program is to survive and continue to contribute to meeting the needs of higher education in America. This is true because the bond-rating agencies require that in any event an issuer be able to show that it will be able to cover its "non-asset bond position," meaning the difference between the amount of bonds issued and the amount of bond proceeds received. An investment-grade rating is not available to an issuer under any set of assumptions to the contrary. Unfortunately, absent the ability of an issuer to retain investment income during the temporary or bond-use period to offset its non-asset bond position, the issuer cannot make that showing. If all such income is required to be rebated, and the issuer is unable in spite its best efforts to acquire student loans, this is referred to as the "non-origination scenario," and it is in fact a potential possibility. Why? Because there can be no guarantee that educational loans, which with certain limited exceptions are required under present rules to be made after the delivery of bonds, will actually be made by originating lenders, or that if made will actually be conveyed to the issuing authority. This is because, on the one hand, lenders may, for a variety of reasons beyond the control of the issuer, decide not to continue making loans.

For example, legislative or regulatory changes in the Guaranteed Student Loan program, or by virtue of changing capital market conditions. Or the other lenders may decide, if loans are made, not to sell such loans as originally anticipated within the permitted bond-use period of a particular student loan bond issue.

There are several other issues that are of concern to student loan bond issuers: One is the cap allocation that came about as the result of the Tax Reform Act of 1988.

I have to report that, as of February 16, 1988, the State of Texas has exhausted all of its cap allocation for the calendar year of 1988, no more than a little over a month and a half into the current year. The South Texas Higher Education Authority at the present time needs to issue additional bonds to continue its financing program but will not be able to do so until or unless an additional cap allocation is made available.

On the other hand, there are probably some States that this year will not use fully, in the course of the full year, their full cap allocation that is available under the existing rules.

The result, simply, is that there is a disparity in treatment as among students that have equal qualifications and should be given virtually the same right of access to financing. But there will be a disparity of treatment as among students in being able to access financing for higher education.

Of course, there are several alternatives, perhaps, to the existing cap rule. One is to take student loan bonds out of the existing cap rules. College billing facilities are out of the cap, for example. Or to provide a separate cap for educational financing; or to develop some other scenario of alternatives for controlling volume where the amount of bonds that would be issued would be the same volume, but where under the special characteristics of the student loan program might be taken into account, such as limiting an insurer to only financing the needs of a certain percentage of the total population of student residents within the area that that particular authority serves.

Second, we have some degree of problem with the permitted bond-use period. We used to have a 36 month permitted bond-use period. That rule, as a result of the Tax Reform Act of 1986, was reduced to 18 months. In effect, what you have, in order to get the same net bond proceeds available to make student loans, you have to do two separate issues to cover the same amount of total net proceeds that you would otherwise have available for student loans.

The difference, though, is that the total volume of bonds to obtain that same amount of net proceeds has to increase, meaning that there are economies of scale in larger size bond issues, that the larger the issue, the smaller percentage of that actually goes to cost of issuance. So, there are efficiencies and economies in larger scale issues. And quite frankly, we probably would tend to support an even longer bond-use period—for example, in that the normal course of instruction at the undergraduate level would be, say, four years.

And this is a program in which we are providing an incentive to lenders to make future loans. Just as the students need commitment for their course of instruction, lenders also look to higher education authorities to be able to assure them that there will be a take-out of their student loans if they choose to participate in making those loans.

Lastly, Senator Mitchell's recent bill would expand tax-exempt financing under the student loan program to include supplemental loans.

This has developed, particularly, by virtue of the fact that there are income limits under the Guaranteed Student Loan Program, essentially limited to $30,000 a year adjusted gross income.

When we started the Student Loan Bond Program in 1976, we were talking about middle-income families in the range of $30,000 per year, and that today equates to about $56,000 in income. So, increasingly so, the Guaranteed Student Loan Program under the Higher Education Act is shifting from middle-income family financing to lower-income financing, and the middle-income family is back in the position that it was in the earlier years, of being without access to financing for higher education.

Additionally, there are students who are attending colleges and universities where the cost of education is in excess of the maximum permitted under the Guaranteed Student Loan Program, which are currently $2625 for the first and second years of attendance at institutions of higher education, and increasing to $4000 for the third and fourth and fifth year, and then $7500 per year thereafter.

Private colleges and universities, in particular, have costs of attendance that are associated there that are in excess of the permitted maximum financing amounts that are available under the Guaranteed Student Loan Program.

Further, supplemental loans would not require other subsidy on the part of the Federal Government as is the case currently with the Guaranteed Student Loan Program.

Some of these other issues are covered more fully in this written statement that I have submitted.

Senator **Moynihan**. Which we will put in the record, and we have some questions for you, which we will give you at the end.

Mr. **Davis**. All right.

Senator **Moynihan** Mr. Begin.

[Mr. Davis' prepared statement appears in the appendix.]

STATEMENT OF HON. ROGER N. BEGIN, GENERAL TREASURER, STATE HOUSE, PROVIDENCE, RI

Mr. **Begin**. Thank you very much, Senator.

My name is Roger Begin. I am the General Treasurer of the State of Rhode Island, and I sincerely appreciate the opportunity to speak before the committee on a subject which I believe is very important to the future of this nation—that is, affordable higher education.

Without a well-educated work force, our dreams for a better future for our children and grandchildren and for America itself are in peril. Indeed, the intense competition we are experiencing from all quarters of the globe points out how vital it is for us to develop our most important resource—the intelligence, imagination and creativity of our people.

We in New England learned long ago that our future was tied to our education system, particularly institutions of higher education.

Recent national trends, however, contain some very ominous implications. College tuition increases have exceeded inflation and are expected to continue to do so.

Tuition costs at public institutions between 1980 and 1984 rose by 49 percent, while family incomes rose by only 29 percent. Compounding that problem is a decline in federal assistance provided to students and their families along with a shift from grants to loan programs. Further compounding the problem is the fact that Americans as a whole just do not save much of their income.

We may now be approaching the point where the percentage of high school graduates able to go on to college will actually begin to decline, and those who are able to go on may find themselves heavily in debt. The implications of such a trend are truly alarming. Indeed, I believe we simply cannot allow that to happen.

The States have been aggressive in taking up this challenge. The Federal Government, as evidenced by this hearing this afternoon, as well has begun to recognize the seriousness of this problem.

There are a number of policy issues relative to college savings programs which need to be considered when developing a specific program.

First, we must remove the disincentives for parents to save for their children's education. Presently, if you or I had the foresight to put aside money each year for education, in most instances the interest on those funds would be taxed at both the State and Federal level. Further, those assets would be held against us when our children apply for financial aid. These policies discourage savings and lead to reduced educational opportunities along with contributing to increased student debt.

Second, it is my belief that any program must preserve the freedom of choice. The prospective student should be able to attend any public or independent college, whether in-state or out-of-state. Programs which construct barriers to free choice will balkanize higher education, and in the long run will not serve the public interest.

Third, we need to recognize that any solutions we propose must take into account that each family has only a limited amount of resources available for education. It is important that these resources be invested wisely. Federal and State programs should complement one another, not compete with each other. Programs must be flexible and adaptable to changing conditions.

In Rhode Island, we have developed a plan which does four things:

First, in order to encourage people to save, we plan to issue college bonds—that is, small denomination tax-exempt "zero coupon" type general obligation bonds of the State. These bonds will be offered to average-income families. We hope that by making it attractive and easy to save, we can encourage parents to plan ahead.

The success of the Illinois program indicates a great demand for this type of college savings plan. The first $90 million in college bonds offered by Illinois this past January was oversubscribed by 300 percent.

Second, we propose to disregard the first $25,000 in Rhode Island College Bonds from the financial asset test when awarding State scholarship grants. This removes a disincentive for savings and further enhances the attractiveness of the college bonds.

Third, we propose to double the funding of our State scholarship program over the next four years. Grants would be increased from $8.5 million per year today to $17 million by the year 1993. This action will help address the problem of declining federal assistance.

Finally, we are proposing that interest earned on special education accounts be exempt from State taxation.

I believe our program provides realistic and sensible options for parents. While these proposals do not represent a complete solution to the problem of affordable higher education, they are clearly a good beginning.

But despite all this activity, the States alone cannot shoulder the entire burden. We need the support and the cooperation of the Federal Government. We need to work together as partners to address this problem. Additional federal grants to students are a priority. We also need federal leadership to encourage savings for education costs by removing the existing disincentives.

The commitment we make to higher education should not be looked upon as an expense but as an investment in America's future, an investment that will return greater dividends in years to come.

As we approach the Twenty-first Century, let us remember that the future belongs to those who prepare for it. The Congress of the United States has an opportunity to help millions of young Americans prepare for the future by taking decisive action at the Federal level to support higher education and to encourage parents to plan and to save for their children's education.

We cannot let this opportunity pass us by. The stakes are too high for our children and for the future of our country. America can remain strong and prosperous only as long as we maintain an informed and well-educated citizenry.

Thank you very much for this opportunity to speak, and I, too, will be happy to answer any questions you have.

Senator **Moynihan**. You are a marvel of controlled presentation—the lights did not come on.

We thank you in particular for the supporting documents which you brought along.

As is our practice, we will now go to Dr. Finnerty, who is our last witness today.

[Mr. Begin's prepared statement and supporting documents appear in the appendix.]

STATEMENT OF DR. JOHN D. FINNERTY, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, COLLEGE SAVINGS BANK, PRINCETON, NJ

Dr. **Finnerty**. Thank you.

I would like to thank all of the members of the Finance Committee for giving me this opportunity to discuss the role the private sector can play in helping resolve the college savings crisis.

Briefly, I am the Executive Vice President and Chief Financial Officer of the College Savings Bank, a New Jersey-chartered FDIC-insured savings bank located in Princeton, New Jersey.

The College Savings Bank was formed for the primary purpose of originating and marketing the CollegeSure CD, a certificate of deposit designed to assure future funding of college costs.

I am also an Adjunct Professor of Business at Fordham University.

Mr. Chairman, most parents feel obligated to contribute toward the cost of their children's college education. Based on a recent Roper study, only about half the families who plan to have one of their children in college are currently saving for college, and the median savings level is under $600 per year. Even among families earning $30,000 or more, only 70 percent are saving for their children's college education, and the median savings level is roughly $1,000 per year. Those who are not currently saving for their children's college education but plan to do so later expect to start saving when the child is 12 years old, which of course only leaves six years to save before the child matriculates. Such savings programs are likely to leave families financially unprepared to pay for their children's college education.

As college costs soar, more and more families are struggling with the task of planning how to finance the cost of their children's college education—a cost that threatens to escalate beyond their reach. The persistently high rates of college inflation present an imposing challenge.

At the current college inflation rate, direct charges—that is, tuition fees, room, and board—for four years at the average private college will cost a member of the Class of 2004 more than $125,000. And if you want to send your child to an Ivy League college, you will have to double that to cover the total cost.

Senator Moynihan. And you mean double that at Princeton?

Dr. Finnerty. At Princeton, it will cost, for a member of the Class of 2004, at current inflation rates, about a quarter of a million dollars for the total cost of four years.

Start saving now.

Over the past 30 years, college costs have increased substantially faster than personal saving per capita. That gap between college costs and family savings is widening at an alarming rate.

Within the past decade alone, college costs have more than doubled—that is, they have increased faster than disposable income per capita—but during the last decade, personal saving per capita has only increased about 16 percent.

The widening gulf between college costs and college savings is the result of two primary factors: the very high rate of college inflation relative to consumer price inflation generally, and the sharp decline in the personal saving rate since the early 1970s.

College costs in fact have increased substantially faster than virtually all consumer prices, but more or less in line with the alarming rise in the cost of medical care services. This development reflects many parents' worst financial fears—having one child in college and a second one in the hospital.

To illustrate the seriousness of the problem, if the average level of personal saving for a typical family of four were dedicated entirely to pay college costs for the two children, it would take about eight years' savings to fund direct charges at the average private college—and that is an increase of about two-thirds over the last decade—and it would take more than three years' savings to fund direct charges at the average public college, and that is up about 50 percent from a decade ago.

College costs are likely to continue outpacing consumer prices by a wide margin in the future. If present trends continue, college savings will prove inadequate for the vast majority of families.

Families need effective college saving vehicles and appropriate saving incentives to help them reach their college goals. In designing an effective college saving vehicle, two characteristics are particularly important. The vehicle should generate adequate after-tax returns to pay for college costs.

First, what after-tax rate of return can the investor expect to realize? And, second, how much college inflation risk does the college saving vehicle eliminate?

A program that grants tax incentives but does not do anything to help alleviate college cost inflation risk fails to address the second question, and may in fact have little impact on the volume of college savings.

Eliminating college cost inflation risk is very important. During the 1980s, college inflation has exceeded consumer price inflation by an average of 4.5 percentage points per year for private institutions, and by more than 2.25 percentage points per year for our public institutions. On an after-tax basis over the past 30 years, only common stocks have produced sufficient rates of return—and even then only on average—to keep pace with rising college costs. And as the events of October 19, 1987, make abundantly clear, common stocks are inherently a very risky investment. They cannot provide the assurance that adequate funds will be available when needed.

The situation families face has worsened over the past 10 years. During that period, the twin problems of high college cost inflation and increased volatility of college inflation have converged. As a result, when you look at the savings rates of the last 30 years, you find that by far the lowest savings rates are concentrated within the last 10-year period.

Addressing the risk dimension of the problem is critically important, and unfortunately, none of the bills that are before the Committee would address that issue.

Granting a tax incentive to college saving may help promote saving, but it represents only a partial solution to the problem and the tax incentive by itself might not augment college savings very much. A recent Roper study found that fewer than half the respondents would save more if the Federal Government granted a tax break for educational savings, but found that three-quarters of the respondents said they would shift existing savings away from other vehicles into the tax-advantaged account.

The private sector can play a significant role in helping families eliminate college cost inflation risk. Currently, there is a product on the market, a specially designed FDIC-insured CD, that enables families to completely eliminate this risk. However, that product is fully taxable.

Achieving the most effective college savings incentive will no doubt require the cooperation of the public sector and the private sector.

I would urge the Committee, if it confers a tax subsidy on college saving vehicles, to establish a level playing field for all college saving vehicles.

At least two approaches are possible to achieve tax-exemption. First, a State can use its current tax-exempt bonding authority to issue tuition prepayment products that are tax-exempt and that eliminate the consumer's college cost inflation risk. Such program proposals have been announced in California and Massachusetts. Such programs could be endowed with the critical features needed to spur college saving without any additional cost to the Federal Government.

An alternative approach could be developed at the Federal level. A Federal plan could be more beneficial to savers than a potpourri of State plans, because the national plan would provide the widest freedom of college choice.

Some form of education savings account, as would be authorized under S. 1533 or S. 1659, would provide a meaningful tax incentive to college saving and would also afford sufficient investment flexibility. Structuring the education savings account along the lines of the IRA would also enable the program to utilize the IRA infrastructure the private sector already has in place, and thereby achieve administrative efficiencies.

I believe it would be worthwhile for the Committee to recommend a tax subsidy to promote college saving. But I also believe it is important to design the subsidy so that it does promote college saving rather than merely make possible tax avoidance.

To do the most good, a federal college saving program should afford investors the flexibility to invest in vehicles that will enable them to eliminate college cost inflation risk, not just reduce their income tax liability.

I am particularly concerned that S. 1662 and S. 1817 would merely shift savings away from traditional investments and reduce federal tax revenues, without generating much net additional savings. I think if you look at the impact of expanding the IRA eligibility in 1981, you see that effect—investments are shifted away from taxable vehicles to the tax-exempt vehicle. There is no net addition to savings.

Generating additional college savings is what this country really needs, and I believe that is the purpose of the bills that we are discussing today. By authorizing a qualified education savings account along the lines of the IRA account, and permitting college savers reasonable investment latitude, I believe that a significant increase in college savings will result.

Thank you.

Senator MOYNIHAN. Thank you, Doctor. Thank you all.

[Dr. Finnerty's prepared statement appears in the appendix.]

Senator MOYNIHAN. I haven't had a chance to ask many questions here, and our Chairman has returned in time, indeed, for Mr. Davis, whose works he admires so much. And as Mr. Davis said, which he has so often before, he has been very involved at the very outset.

Mr. Chairman, we have just heard from each on the panels, and now it is question time.

The **Chairman**. Why don't you proceed?

Senator **Moynihan**. There is one question which one of our economists on the Joint Committee on Taxation wanted to address to each of you, with the different perspectives of your involvement: Why is it that you feel college costs will continue to rise faster than the rate of inflation?

I see Dr. Finnerty referred to Bill Bowen's 1969 study which argues that they have done so all through the century. Is that so?

Dr. **Finnerty**. Mr. Chairman, yes, that is correct. I have done a pretty careful review of the literature, and I would say that Bill Bowen's study, even though it was produced back in 1969, is still the very best study, the most definitive subject on the subject.

In fact, it is interesting to read what he has to say. You would think that that study was written in 1987 or 1988. He talks, for example, about limited opportunities for productivity improvement in the educational sector, the fact that colleges do have a social mandate, and they want to introduce new programs, and that such activity is very labor-intensive.

Dr. Bowen also talks about the need for salary catch-up, which is a very big problem again today, and the need to spend large sums on maintenance, because maintenance had been deferred.

Senator **Moynihan**. We probably will get a little presci of that.

I guess that is what is, in your profession, an economist called Bogle's disease.

Dr. **Finnerty**. Dr. Baumol, yes.

Senator **Moynihan**. You know, why does the opera cost so much more than anything else? Because you just can't produce much productivity out of Pavarotti.

Dr. **Finnerty**. That is right, and it is interesting that Dr. Bowen wrote a study of the arts prior to his study on education. I guess it was his work on examining the economics of the arts—the opera, the theater, and so on—which led him into education, but it is the very same in both cases.

Senator **Moynihan**. The Aida still takes fifteen and a half hours.

Dr. **Finnerty**. That is right. Professors like to talk about sitting around with a couple of dozen students. You can sit around with a couple of hundred students or a couple of thousand students, but eventually you just—you know, you can't hire Madison Square Garden to teach Calculus 101.

Senator **Moynihan**. Thank you.

The **Chairman**. Well, thank you very much, Senator Moynihan.

Bill Davis has an unusual program down there, and I am sure he went into it in some detail.

Senator **Moynihan**. He went into great detail.

The **Chairman**. Good. And it has been a great success story.

Senator **Moynihan**. I pretended to follow it all.

The **Chairman**. And what he has been able to do down there—we really had a situation where the banks wouldn't make the loans, because they said their costs were so much that they really wouldn't make a profit off of it.

We have an area down there in South Texas that unfortunately has the highest unemployment rate in the United States, and one of the lowest per-capita incomes, and not much of a tax base.

So, we brought those bankers together and those S&L authorities back in the early seventies and made the point to them that if they ever wanted their savings to grow, and their deposits to grow, those people down there had to have more discretionary income, they had to have some money they could save, some deposits they could put in, and that the best way to do that was through education.

They went out and got a $300,000 EDA loan, seed money. That is probably one of the few EDA loans that was ever paid back in full.

But now you have over 25,000 students—isn't that about right?—who have borrowed money and have gone to some 800 different colleges and universities. You have had well over $100 million that has been loaned.

How much is that being duplicated across the country now? Do you know?

Mr. DAVIS. Well, Senator, 39 States and the District of Columbia and Puerto Rico have utilized that model to provide for that special niche of need in their education that this particular program takes care of.

I would also point out that it is not a concept that is designed all of the needs of education financing, but only a very limited specialized area of need. And certainly there are areas in States, New York being one, where there is not much need for a secondary market to provide incentives to the lenders. There are lenders who are willing to make and retain those loans over repayment that don't need the secondary market program that we have developed for our area. So that it is not designed to accommodate all of the needs for higher education financing but only the limited areas of need where those loans would not otherwise be made.

The CHAIRMAN. You know, Senator, we have a lot of frustrations around this place, but every once in a while you win one, and that is what makes it all worthwhile.

I recall one night watching one of the networks. They did a story on a family whose children all went to college. I think the father handled the fresh fruit counter at the supermarket up there in that little town on the border. One of the sons became a pharmacist, another became a doctor, another became the principal of a school, another became a math instructor, and they had all of their degrees up there in that living room. An incredible achievement for that family. But they were able to do it through the loan process.

I am delighted to have you testify.

Dr. Finnerty, I understand that you made some comments expressing concern about the savings bond approach as opposed to a savings account. Can you tell me what your concern is?

Dr. FINNERTY. I made a couple of comments about the savings bond program, S.1662 and S.1817 in particular. I am concerned that that particular program might simply lead to a shift of savings out of taxable vehicles into the tax-exempt account.

Earlier testimony today suggested that Treasury would simply raise money by selling savings bonds and basically replace the sale of long-dated Treasury bonds. But the type of vehicle that they have in mind would be sold to individuals, whereas Treasury bonds are typically sold to institutions on both sides of the Atlantic.

I am afraid that, as in the case of the IRA accounts, when eligibility was expanded in 1981, because college inflation risk is not reduced, you may find that large sums of money are shifted out of taxable vehicles into tax-exempt vehicles without any net addition to savings. And I think the spirit of the legislation that is under consideration is to increase the volume of savings so that we can get people better prepared for college and reduce the loan burden.

The CHAIRMAN. I defer to Senator Baucus. Thank you very much.

Senator BAUCUS. Thank you very much, Mr. Chairman.

I, of course, was not able to be here this morning as I was chairing another hearing, but it is obvious that we need to bolster assistance for elementary and secondary education as well as higher education in America.

We all know the problems. As has been pointed out, there has been a shift from grant to loan, and inflation, and all of the other problems facing higher education.

I just want to thank you all for the length of this hearing and the depth in which you have gone into it, Mr. Chairman and Senator Moynihan.

I think Senator Kennedy's bill and others are valuable contributions. I know there is a similar bill in the House.

As much as I favor increasing aid to higher education—I have a son coming along, so I have a special interest—I also believe that elementary and secondary education in this country has to be significantly improved. I think it is a good system, but I just spent last week in Japan. I am not going to say that the Japanese have all of the answers, but I want to say that our country is going to have to get on with it if we are going to increase our competitiveness. And a lot of that has to do with education.

It also has to do with education for all Americans, particularly lower-income and middle-income Americans. One of the strengths, obviously, of the Japanese system is its homogeneity. Japanese children are educated well, truly, since basically the parents take such a strong interest in education—perhaps a stronger interest even than do American parents in the education of their kids.

Second, in Japanese education, equal education is available virtually to every single Japanese student in the elementary and secondary schools. It is all available. It is all there, regardless of income.

I think the more we can focus on the lower-income end of education in this country, too, so everyone has an opportunity, where it increases productivity, that that is going to help American productivity, so we can compete with other countries in the world.

I want to just thank you for your contributions.

The CHAIRMAN. Gentlemen, thank you very much for your attendance and contributions.

[Whereupon, at 3:23 p.m., the hearing was adjourned.]

[The prepared statement of Senator Heinz appears in the appendix.]

APPENDIX

STATEMENT OF CHAIRMAN BENTSEN

EDUCATION TAX INCENTIVES

TODAY, AMERICA FACES GROWING UNCERTAINTY ABOUT ITS ABILITY TO COMPETE IN A GLOBAL ECONOMY THAT IS BEING BUFFETED BY SWIFT TECHNOLOGICAL CHANGE, CHANGE THAT AFFECTS THE CURRENT AND FUTURE WORKFORCE. THERE IS NO UNCERTAINTY IN MY MIND THAT AMERICANS REMAIN HARD, DEDICATED WORKERS. EQUIPPED WITH THE PROPER KNOWLEDGE, THE PROPER SKILLS, THE PROPER MOTIVATION, I'LL PUT AMERICAN WORKERS UP AGAINST ANY WORKERS ANYWHERE. AND, I'LL WIN. THIS HEARING TODAY CENTERS ON OUR ABILITY TO HELP PROPERLY EQUIP AMERICANS WITH THE KNOWLEDGE NEEDED TO COMPETE AND THE KNOWLEDGE NEEDED TO MAINTAIN AND IMPROVE AMERICA'S STANDARD OF LIVING.

EDUCATION REMAINS THE KEY TO OUR COUNTRY'S FUTURE ECONOMIC PROSPERITY. THE EDUCATIONAL OPPORTUNITIES AVAILABLE TO FUTURE GENERATIONS WILL DETERMINE THE STRENGTH OF OUR ECONOMY AND ULTIMATELY WHETHER OUR NATION'S STANDARD OF LIVING WILL RISE OR FALL. EDUCATION HAS ALWAYS BEEN A PRIORITY FOR OUR COUNTRY, BUT NOW IT TRULY MUST BE A TOP PRIORITY.

WE ARE FACING GREAT UNCERTAINTY ABOUT OUR ECONOMY. OUR NATION EXPERIENCED A RECORD TRADE DEFICIT LAST YEAR OF OVER 171 BILLION DOLLARS. ONE OF THE MOST EFFECTIVE MEANS TO IMPROVE THE COMPETITIVENESS OF AMERICAN PRODUCTS IS TO

IMPROVE THE SKILLS OF OUR WORKFORCE. A SKILLED LABOR FORCE WILL HAVE THE TOOLS TO DEVELOP NEW PRODUCTS AND KEEP OUR COUNTRY ON THE CUTTING EDGE OF NEW TECHNOLOGY.

TO THRIVE IN THE 21ST CENTURY, U.S. BUSINESSES WILL NEED MORE AND BETTER COMPUTER SCIENTISTS, ENGINEERS, MATHEMATICIANS AND OTHER SPECIALISTS. YET, ACCORDING TO THE NATIONAL SCIENCE FOUNDATION, A DECLINING PERCENTAGE OF AMERICAN STUDENTS ARE ENTERING THE FIELD OF SCIENCE AND ENGINEERING. AMONG OUR CHIEF COMPETITORS, THE PROPORTION OF THE LABOR FORCE DEDICATED TO RESEARCH AND DEVELOPMENT HAS GROWN RAPIDLY IN THE LAST 20 YEARS, WHILE OUR OWN COMMITMENT HAS NOT INCREASED AT ALL.

SUSTAINED GROWTH IN U.S. PRODUCTIVITY GOES HAND IN HAND WITH EDUCATION. IN THE 1980'S, U.S. PRODUCTIVITY INCREASES HAVE BEEN AT HISTORICALLY LOW LEVELS, WHILE OUR TRADING PARTNERS HAVE EXPERIENCED MUCH FASTER PRODUCTIVITY GROWTH. CONSEQUENTLY, THEY ARE FAST APPROACHING U.S. STANDARDS OF LIVING.

THESE STATISTICS REPRESENT AN URGENT WARNING THAT WE NEED TO ENHANCE THE EDUCATIONAL LEVELS IN THIS COUNTRY. BUT, WHAT WE ARE SEEING INSTEAD IS THAT ACCESS TO AN AFFORDABLE COLLEGE EDUCATION HAS BEEN DRIFTING FARTHER AWAY. THE INCREASE IN COLLEGE EXPENSES FOR THE 1987-88 ACADEMIC YEAR FOR PRIVATE FOUR-YEAR COLLEGES AVERAGED 8 PERCENT. SIMILAR

INCREASES WERE RECORDED FOR PUBLIC COLLEGES. THAT IS THE SEVENTH STRAIGHT YEAR THAT COLLEGE COSTS HAVE OUTPACED INFLATION. WE HAVE NOW REACHED THE AGE OF THE 75,000 DOLLAR BACHELORS DEGREE AT SOME OF OUR NATION'S MOST PRESTIGIOUS SCHOOLS. THAT IS A 50 PERCENT INCREASE IN ONLY FIVE YEARS.

FEDERAL SUPPORT FOR HIGHER EDUCATION HAS NOT KEPT PACE. TAKING INFLATION INTO ACCOUNT, FEDERAL EXPENDITURES FOR STUDENT AID HAVE INCREASED BY ONLY 3 PERCENT SINCE 1980, ACCORDING TO THE OFFICE OF MANAGEMENT AND BUDGET.

THAT HAS FORCED FAMILIES TO RELY MORE ON THEIR PERSONAL SAVINGS AND ON BORROWING TO FUND COLLEGE EDUCATIONS. YET, THE NATIONAL SAVINGS RATE LAST YEAR DROPPED TO 3.8 PERCENT. THAT IS OUR LOWEST RATE OF PERSONAL SAVING, AS A PERCENT OF DISPOSABLE INCOME, IN 40 YEARS.

THESE FACTORS MAKE IT HARDER AND HARDER FOR STUDENTS AND THEIR FAMILIES TO AFFORD A COLLEGE EDUCATION. THAT DOES NOT BODE WELL FOR THE FUTURE DIRECTION OF OUR ECONOMY.

THE FEDERAL TAX CODE CURRENTLY CONTAINS A NUMBER OF PROVISIONS TO PROMOTE EDUCATION, BUT THEY MAY NOT BE ENOUGH. THAT'S WHY WE HAVE ASSEMBLED A PANEL OF EXPERTS TODAY TO DISCUSS THE TRACK RECORD OF FEDERAL TAX EXPENDITURES. WE ALSO WILL HEAR TESTIMONY ON SEVERAL NEW PROPOSALS TO PROMOTE EDUCATIONAL SAVINGS, INCLUDING AN EDUCATIONAL SAVINGS BOND

PROGRAM. I HAVE LONG SPOKEN OUT ON HOW WE MUST IMPROVE OUR NATION'S SAVINGS RATE. THAT'S WHY SOME OF THE SUGGESTIONS WE WILL CONSIDER ARE ATTRACTIVE TO ME. THIS HEARING WILL PROVIDE US AN OPPORTUNITY TO REVIEW THE PROS AND CONS OF THESE INITIATIVES AND TO CONSTRUCT A GUIDE FOR SETTING FUTURE TAX POLICY THAT ENHANCES EDUCATIONAL OPPORTUNITY.

STATEMENT OF SENATOR GEORGE J. MITCHELL

SENATE COMMITTEE ON FINANCE
HEARING ON EDUCATION TAX INCENTIVES
MARCH 16, 1988

I want to thank the Chairman for holding this hearing on proposals to provide tax incentives to make higher education more affordable.

Our society has always placed a high priority on education as a means by which Americans can realize their full potential. We are proud that this nation was founded on the concept of equal opportunity for all persons. But equal opportunity is little more than a slogan if people do not also have the means to realize their potential through an education. For that reason, the federal government has a particularly important role in issues of higher education.

Today, we have reason to be concerned that higher education is becoming less and less affordable. Federal aid to education has fallen and fewer students are eligible for federal assistance. Meanwhile, the cost of higher education continues to rise at a rate much faster than family income. A recent study found that 82 percent of the American public believe that rising costs will soon put a college degree our of reach of most families. For too many Americans, the availability of a higher education is more an ideal than a reality.

That is a disturbing situation but it is difficult to address in the current budget climate. For that reason, there is growing interest in using the tax system to make higher education more affordable for American families.

Several bills have been introduced in Congress to provide tax incentives to enable families to afford a college or vocational school education. A typical approach is to create an incentive to save for a college education by exempting the interest income from taxation. Most of those bills are targeted, much like IRAs, to limit the tax incentive to those who would not otherwise have the resources to save for education.

These bills deserve serious consideration. I am particularly intrigued with the proposal by Senators Kennedy and Pell to encourage tax free savings for education through savings bonds. This is a simple program, well targeted to families in need of educational assistance who would not otherwise save on their own.

This legislation should not, however, be seen as an answer to the problem today. It will take many years for a savings program to become fully effective. And, not all deserving students are fortunate enough to have family who will be able to save for future education needs. Savings programs should be seen as a complement to grants and loans, not as a replacement.

Particularly in the short-term, students loans are likely to remain the primary means of federal assistance for students and parents to finance higher education.

Six Members of this Committee have joined me in introducing legisation to facilitate the availablity of funds for student loans through tax-exempt financing. This legislation would extend current law rules permitting student loan bond authorities to earn arbitrage for a period of 18 months to cover issuance costs. It also extends those rules to supplemental bonds.

Understandably, we have an instinctive aversion on this Committee to the earning of arbitrage by tax-exempt bond issuers. The federal tax-exemption should not be an income source to issuers. However, student loan bonds present an entirely different case with respect to arbitrage. Costs of administering a student loan bond program are far higher than with other programs which have loans with much larger outstanding balances. Yet, program costs cannot be recovered from the student borrowers at the time of issuance, like other bonds. Furthermore, the Federal government has a particularly important interest in assuring the availability of funds to finance student loans to make higher education affordable. That interest is manifest in the operations of the student loan program which is designed specifically to operate with tax-exempt bonds though the Department of Education.

I hope the Members of this Committee will take a serious look at the issues involved with this legislation and agree that we should continue to permit arbitrage to fund administration and issuance costs of student loan bonds.

Testimony will also be received today on state efforts to establish tuition prepayment programs whereby families make discounted payments today to entitle their children to a future education in state supported colleges. Maine and other states, as well as some universities, have established such programs. They are to be congratulated for taking this kind of imaginative initiative to help make higher education affordable.

Again, I want to thank the Chairman for calling this hearing. I look forward to receiving the testimony today.

STATEMENT OF JOHN HEINZ

THE HEARING TODAY FOCUSES ON THE VARIOUS TAX INCENTIVES FOR HIGHER EDUCATION. I BELIVE ONE OF THE MOST IMPORTANT GOALS WE HAVE TODAY IS TO PROVIDE EDUCATION FOR EVERYONE. OUR GOAL FOR EDUCATION IS TO PROMOTE A LEVEL OF QUALITY AND CHOICE FOR OUR STUDENTS. WE CLEARLY HAVEN'T REACHED THAT GOAL. QUALITY AND CHOICE UNFORTUANATELY COMES WITH A PRICE TAG, AND WE MUST BE WILLING TO PAY THAT PRICE.

WE WILL BE DISCUSSING PROVISIONS WHICH WE HAVE ENACTED IN THE PAST, AND NEED TO MAKE PERMANENT LIKE EMPLOYER EDUCATION ASSISTANCE AND LOOKING AT VARIOUS NEW PROPOSALS. TAX INCENTIVES SUCH AS EMPLOYER PROVIDED EDUCATION ASSISTANCE AND STUDENT LOAN BONDS ARE SOME OF THE MOST EFFECTIVE WAYS OF PROVIDING AFFORDABLE EDUCATION FOR THE AMERICAN PUBLIC. HOWEVER, THESE INCENTIVES ALONE ARE CLEARLY NOT ADEQUATE TO COVER THE HIGH COST OF EDUCATION.

EMPLOYER EDUCATION ASSISTANCE ACT, SECTION 127 OF THE TAX CODE, HAS NOW EXPIRED. I JOINED WITH SENATOR MOYNIHAN AND 4 OF MY FINANCE COLLEAGUES TO INTRODUCE S. 39, A BILL WHICH WOULD MAKE THE PROVISION PERMANENT. THIS BILL NEEDS TO BE ENACTED AS QUICKLY AS POSSIBLE. SINCE THE BILL WAS ENACTED IN L978, OVER 7 MILLION WORKERS HAVE USED THE PROVISION TO

ADVANCE THEIR EDUCATION. SINCE IT HAS EXPIRED MANY SCHOOLS AND EMPLOYERS ARE NOW WITHHOLDING TAXES ON THE AMOUNTS PAID FOR TUITION. I AM RECEIVING LETTERS EACH DAY FROM GRADUATE STUDENTS WHO BECAUSE OF THE TAX LAW CHANGES, AND THE EXPIRATION OF SECTION 127 MAY HAVE TO DROP OUT OF SCHOOL. THAT IS CLEARLY NOT A RESULT THAT WE WANT.

WHILE, I BELIEVE THAT EMPLOYEE EDUCATION ASSISTANCE IS AN IMPORTANT TOOL, IT IS NOT ENOUGH. LAST YEAR AN ARTICLE IN THE WASHINGTON POST SHOWED THE RISING COST OF EDUCATION, WHICH WAS CLIMBING MORE RAPIDLY THAN INFLATION. THE ARTICLE STATED THAT AT THE MOST PRESITGIOUS PRIVATE COLLEGES AND UNIVERSITIES, THE TOTAL COST OF A 4 YEAR BACHELOR'S DEGREE COST HAD REACHED $75,000.

AT THAT TIME, I JOINED WITH SENATOR DOLE IN INTRODUCING 4 BILLS WHICH OFFERED VARIOUS SOLUTIONS TO THE PROBLEMS. THE BILLS RANGED FROM PROVIDING FOR AN EDUCATIONAL SAVINGS BONDS TO DIFFERENT TYPES OF EDUCATIONAL SAVINGS ACCOUNTS. THE PURPOSE OF THOSE BILLS WAS TO START THE DEBATE ON EXACTLY WHICH TAX INCENTIVES WE SHOULD BE PROVIDING TO ENCOURAGE SAVINGS FOR COLLEGE EDUCATION. THE HEARING TODAY, PROVIDES THE OPPORTUNITY TO REVIEW THE VARIOUS PROPOSALS, AND DEVELOPE INCENTIVES THAT WILL WORK.

THERE IS LITTLE DOUBT THAT SAVINGS INCENTIVES ARE NECESSARY. THE SAVINGS RATE IN THE UNITED STATES IS AT AN ALL TIME LOW.

IN 1986, AMERICAN HOUSEHOLDS SAVED ONLY 3.9 PERCENT OF THEIR DISPOSABLE INCOME. WHEN YOU CONSIDER THAT THE AVERAGE TUITION FOR FOUR-YEAR COLLEGE IS $1,359, WITH ESTIMEATED COSTS FOR STUDENTS WHO LIVE ON CAMPUS TOTALLING $5,789. AMOUNG ALL PRIVATE FOUR YEAR COLLEGES, THE AVERAGE TUTION IS $7,110. TOTAL ESTIMATED COSTS FOR A STUDENT LIVING ON CAMPUS WILL BE JUST UNDER $12,000. THESE ARE TODAYS FIGURES, AND THERE IS NO WAY TO PREDICT HOW MUKCH IT WILL COST IN 10 YEARS.

MR. CHAIRMAN, I LOOK FORWARD TO THIS HEARING TODAY, AND WORKING WITH THE COMMITTEE TO PROVIDE TAX INCENTIVES THAT WORK. PROVIDING THE MEANS TO PAY FOR HIGHER EDUCATION IS A GOAL FOR EVERYONE ON THIS COMMITTEE, AND WORKING TOGETHER WE WILL FIND A SOLUTION.

FINANCE COMMITTEE HEARING ON
TAX INCENTIVES FOR EDUCATION
STATEMENT BY
SENATOR DAVE DURENBERGER
MARCH 15, 1988

MR. CHAIRMAN, I WANT TO COMMEND YOU FOR HOLDING THIS MORNING'S HEARING. WE IN THIS COUNTRY HAVE THE FINEST UNIVERSITY EDUCATION SYSTEM IN THE WORLD. YET, WHAT GOOD IS THIS EDUCATION SYSTEM, IF THE MIDDLE-INCOME AMERICAN FAMILY CANNOT AFFORD TO SEND THEIR CHILDREN TO THESE COLLEGES?

LAST SUMMER, THE COLLEGE BOARD ISSUED ITS ANNUAL SURVEY OF COLLEGE COSTS. THE FINDINGS OF THAT REPORT ARE STAGGERING. THE AVERAGE COST FOR A STUDENT ATTENDING A PRIVATE COLLEGE IS $12,000 A YEAR. AT PUBLIC COLLEGES, THE COST IS NEARLY $6,000 A YEAR. AND AT SOME UNIVERSITIES, THE COST OF FOUR YEARS OF EDUCATION CAN RUN AS HIGH AS $75,000.

WHAT THESE FIGURES SUGGEST IS THAT THE UNITED STATES TODAY IS FACING A CRISIS THAT WILL HAVE EXTRAORDINARY IMPLICATIONS FOR THE ECONOMIC AND MILITARY SECURITY OF THIS NATION INTO THE NEXT CENTURY. AS THE COST OF A COLLEGE EDUCATION CONTINUES TO OUTPACE INFLATION, FEWER AND FEWER MIDDLE-CLASS AMERICANS WILL BE ABLE TO AFFORD TO SEND THEIR CHILDREN TO COLLEGE. AND THOSE WHO MAKE THE COMMITMENT TO THEIR CHILDREN'S EDUCATION WILL FIND THEMSELVES BURDENED BY EXTRAORDINARY DEBT.

AS OUR ECONOMY HAS BECOME MORE GLOBALLY ORIENTED AND COMPETITIVE; AS IT BECOMES MORE TECHNOLOGICALLY SOPHISTICATED, OUR NEED FOR A WELL-EDUCATED WORKFORCE BECOMES CRITICAL. PART OF THE REASON WE HAVE BEEN LOSING OUR INDUSTRIAL COMPETITIVENESS TO JAPAN IS BECAUSE JAPAN HAS A HIGHER LITERACY RATE THAN THE UNITED STATES AND, IN MANY CASES, A BETTER-EDUCATED WORKFORCE THAT CAN MORE EASILY ADAPT TO NEW TECHNOLOGIES IN THE WORK PLACE.

IF WE FAIL TO INVEST IN THE EDUCATION OF OUR CHILDREN, OR IF WE MAKE EDUCATION ONLY AVAILABLE TO THE WEALTHIEST FIVE PERCENT OF OUR CITIZENS, WE WILL CONDEMN FUTURE GENERATIONS TO SECOND-CLASS STATUS IN THE WORLD AND WILL CREATE UNPRECEDENTED DIVISIONS WITHIN OUR SOCIETY.

MR. CHAIRMAN, NO ONE IN AMERICA SHOULD BE DENIED ACCESS TO THE BEST EDUCATION POSSIBLE MERELY BECAUSE OF MONEY. YET IF THE COST OF A COLLEGE EDUCATION CONTINUES TO SKYROCKET, ONLY THE LUCKY FEW WHO HAVE THE FINANCIAL MEANS WILL BE ABLE TO GAIN THE SKILLS THAT WILL BE CRITICAL IN THE ECONOMY OF THE TWENTY-FIRST CENTURY.

I HAVE COSPONSORED MANY OF THE BILLS THAT ARE BEING CONSIDERED IN THIS MORNING'S HEARINGS, AND HAVE LONG SUPPORTED THE IDEA THAT CONGRESS ESTABLISH A PROGRAM THAT WOULD PROVIDE FAMILIES WITH TUITION TAX CREDITS TO OFFSET EDUCATIONAL COSTS. LEGISLATION PROVIDING TAX INCENTIVES FOR FAMILIES TO SAVE FOR THEIR CHILDREN'S COLLEGE EDUCATION--WHETHER EDUCATIONAL IRAS OR EDUCATION SAVINGS BONDS--REPRESENTS A POSITIVE INVESTMENT FOR THE FUTURE THAT IS WORTH EXPERIMENTING WITH.

IN THE 1986 TAX REFORM LEGISLATION, WE MADE A MISTAKE IN ELIMINATING THE INTEREST DEDUCTION FOR COLLEGE EDUCATION LOANS, AND I HOPE THAT WE WILL ADOPT SENATOR GRASSLEY'S BILL REINSTATING THE DEDUCTION FOR COLLEGE LOAN COSTS. ALTHOUGH WE ALLOW HOMEOWNERS TO TAKE OUT HOME EQUITY LOANS TO PAY FOR COLLEGE EDUCATION EXPENSES, BY SO DOING, WE ARE DISCRIMINATING AGAINST THOSE FAMILIES WHO CANNOT AFFORD TO OWN THEIR OWN HOMES. AND WHAT ABOUT THOSE FAMILIES IN RURAL MINNESOTA AND OTHER RURAL AREAS, WHO, OVER THE PAST SEVERAL YEARS, HAVE SEEN THEIR HOME EQUITY SHRINK WITH THE DEFLATION THAT HAS OCCURRED THROUGHOUT RURAL AMERICA? THEY HAVE LITTLE OR NO EQUITY TO BORROW AGAINST.

I ALSO BELIEVE IT IS IMPERATIVE THAT WE EXTEND THE SECTION 127 RULES ALLOWING EMPLOYERS A DEDUCTION FOR FUNDING EDUCATIONAL EXPENSES FOR THEIR EMPLOYEES. I THINK IT IS CLEAR THAT INDIVIDUALS MUST VIEW EDUCATION AS A LIFE-LONG PROCESS THAT MUST BE CONTINUOUSLY UPDATED IN ORDER TO MAINTAIN THE SKILLS AND KNOWLEDGE WHICH ARE VITAL TO A COMPETITIVE ECONOMY.

THANK YOU, MR. CHAIRMAN.

TAX INCENTIVES FOR EDUCATION

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FINANCE

ON

MARCH 15, 1988

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on March 15, 1988, on tax incentives for education. This pamphlet,[1] prepared by the Staff of the Joint Committee on Taxation, provides a description of certain proposals for education tax incentives and an analysis of issues relating to such proposals.

The first part of the pamphlet is a summary of present law and the proposals. The second part describes present law and proposals relating to education savings bonds, education savings accounts, National Education Savings Trust, interest deduction on education loans, employer-provided educational assistance, and certain student loan bonds. The third part is an analysis of issues relating to such proposals. An Appendix provides information on direct aid to students for post-secondary education.

I. SUMMARY

Education Savings Bonds

Present law

Present law does not include an exclusion from gross income, or deferral of taxation, for interest or other income specifically because the taxpayer uses the income for educational expenses. Taxation of interest accruals on U.S. Series EE savings bonds may be deferred by cash-basis taxpayers as long as the bonds are not redeemed.

S. 1817 (Senators Kennedy and Pell)

Interest income on a qualified U.S. savings bond would be excluded from income when such bonds are transferred to an eligible educational institution as payment for the higher education expenses of a taxpayer, taxpayer's spouse, or dependents. The exclusion would be phased out for taxpayers with adjusted gross income between $75,000 and $150,000.

The bill would apply to transfers of qualified U.S. savings bonds issued after the date of enactment.

S. 1662 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

This bill would authorize issuance of educational savings bonds (a special form of Series EE bonds) at the prevailing Federal long-term rate. A taxpayer could purchase annually for the benefit of a dependent up to $1,000 of such bonds on which interest would accrue tax-free. The accrued interest would be excluded from income in the year of redemption if used for higher education expenses. The interest exclusion would apply only if the taxpayer holds the bonds for at least one year, and not more than 20 years, after issuance.

The bill would apply for taxable years beginning after December 31, 1986.

Administration proposal

The President's budget proposals for fiscal year 1989 include a recommendation to exclude from gross income the interest on certain U.S. savings bonds that are redeemed to pay post-secondary educational expenses of the taxpayer or the taxpayer's spouse, children, or other dependents. The exclusion would be phased out for taxpayers with adjusted gross income above certain levels.

The exclusion would apply to bonds issued after December 31, 1988.

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Educational Savings Accounts

Present law

Present law does not provide a specific deduction, credit, or income exclusion for amounts contributed to a trust to fund education expenses of the taxpayer or a child of the taxpayer.

S. 1533 (Senator DeConcini)

Taxpayers would be allowed an above-the-line deduction for cash contributions (up to $1,000 per year) made to an education savings account established to pay for future education expenses of the taxpayer or a dependent at an institution of higher education or vocational school. The deduction would be reduced for taxpayers with adjusted gross income above certain levels, similarly to the phase-out of the IRA deduction. Income earned by the education savings account generally would be exempt from taxation.

The bill would be effective for taxable years beginning after December 31, 1986.

S. 1659 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

This bill includes provisions for educational savings accounts that generally are the same as the provisions in S. 1533, as summarized above. However, S. 1659 would allow a 15-percent tax credit (up to $150 per year), rather than a deduction, for amounts paid in cash and the fair market value of stocks, bonds, or other readily tradeable securities transferred to an education savings account.

S. 1660 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

This bill is the same as S. 1659, except that no credit or deduction would be allowed for contributions to an education savings account. Earnings on amounts transferred to such account generally would not be taxable unless distributed for noneducational purposes.

S. 1661 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

This bill is the same as S. 1659, except that, for each taxable year, a 15-percent tax would be imposed on the taxable income of an education savings account, i.e., the gross income of the account minus any deductions directly allocable to such income.

National Education Savings Trust

Present law

Under present law, there is no provision that permits deductions for amounts contributed to a national trust to fund education expenses of the taxpayer or a child of the taxpayer.

S. 1572 (Senators Pell, Kennedy, and Stafford)

This bill would establish a public corporation, the National Education Savings Trust, which would enter into advance tuition payment plan agreements with taxpayers. Amounts paid by a taxpayer to the Trust pursuant to such an agreement would be deductible by the taxpayer up to $2,000 per year; the deduction would be reduced for taxpayers with adjusted gross income above certain levels. Amounts paid by the Trust to post-secondary education institutions would not be subject to Federal income tax.

Interest Deduction on Education Loans

Present law

Pursuant to the Tax Reform Act of 1986, the itemized deduction for personal interest (including interest on student loans) is being phased out over 1987-1990.

S. 628 (Senators Grassley, Danforth, D'Amato, Kerry, Durenberger, and Hecht)

The bill provides that interest on loans incurred for qualified education expenses would be deductible as an itemized deduction, effective for taxable years beginning after December 31, 1986.

Employer-Provided Educational Assistance

Present law

An employee must include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to the employee, unless the cost of such assistance qualifies as a deductible job-related expense of the employee. Under prior law (Code sec. 127), an employee's gross income and wages for income and employment tax purposes did not include amounts (up to $5,250 per year) paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements. The section 127 exclusion expired for taxable years beginning after December 31, 1987.

S. 39 (Senators Moynihan, Heinz, Boren, Pryor, Matsunaga, and Riegle)

The bill would reinstate the section 127 exclusion, effective as of its expiration date, on a permanent basis.

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Certain Student Loan Bonds

Present law

Present law includes a special rule permitting qualified scholarship funding corporations (rather than States or local governments themselves) to issue tax-exempt student loan bonds in connection with the Federal Guaranteed Student Loan (GSL) or PLUS programs. Present law further includes two special exceptions providing (1) that issuers of tax-exempt student loan bonds issued in connection with these Federal programs may invest bond proceeds to earn arbitrage profits for a longer temporary period than applies to similar types of bonds and (2) that all or a portion of these arbitrage profits are exempt from the rebate requirement generally applicable to all other tax-exempt bonds. These two arbitrage exceptions are scheduled to expire with respect to bonds issued after December 31, 1988.

S. 2149 (Senators Mitchell, Pryor, Durenberger, Boren, Danforth, and Rockefeller)

The bill would permit qualified scholarship funding corporations to issue State supplemental student loan bonds, which are student loan bonds not subject to the restrictions of or receiving the benefits of the Federal GSL or PLUS programs. Also, the bill would make permanent the two special arbitrage exceptions and would extend these provisions to issuers of supplemental student loan bonds.

II. DESCRIPTION OF PROPOSALS

A. Education Savings Bonds

Present Law

Present law does not include an exclusion from gross income, or deferral of taxation, for interest or other income specifically because the taxpayer uses the income for educational expenses.

Certain types of investment income are excluded from gross income or are tax-deferred regardless of the taxpayer's use of such income. For example, interest income on qualified State and local government bonds generally is exempt from Federal income taxation. Taxation of income credited to life insurance or annuity contracts ("inside buildup") is deferred until distributed to the policyholder; such income is not taxed if paid to a designated beneficiary after the death of the insured individual (in the case of a life insurance contract). In addition, taxation of income earned on amounts contributed to an individual retirement arrangement (IRA) or an employer-maintained qualified pension plan generally is deferred until the amounts are distributed to the owner of the IRA or to the employee participating in the employer-maintained plan.

Taxation of interest accruals on U.S. Series EE savings bonds may be deferred by cash-basis taxpayers as long as the bonds are not redeemed.

Explanation of Proposals

S. 1817 (Senators Kennedy and Pell)

Exclusion

S. 1817 would provide an exclusion from gross income for the interest income earned on a qualified U.S. savings bond if the bond is transferred to an eligible educational institution as payment for the higher education expenses of a taxpayer, or taxpayer's spouse or dependents. The amount of exclusion allowed for a taxable year would be the lesser of (1) the amount that otherwise would be includible in gross income by reason of such transfer, or (2) amount of such higher education expenses.

The exclusion would be phased out for a taxpayer with adjusted gross income (AGI) of $75,000 or more for the taxable year; no amount could be excluded by a taxpayer whose AGI is $150,000 or more. For a taxpayer with AGI between $75,000 and $125,000, 67 percent of the eligible amount could be excluded; for AGI between $125,000 and $150,000, 34 percent of the eligible amount could be excluded. The phase-out amounts would be indexed in calendar years after 1988.

Only one-half of the dollar amounts described above would apply in the case of a married individual filing separately. With respect to a taxpayer who is a dependent of another taxpayer, the phaseout would be applied by taking into account the AGI of both taxpayers.

Transferability of U.S. savings bonds

The ability to effect a transfer of a U.S. savings bond for the educational purposes of the bill would be made possible by amending 31 U.S. Code section 3105, which provides the Treasury with authority to prescribe the conditions, including restrictions on transfer, relating to the issue of U.S. savings bonds. The amendment relates to both the transfer of a qualified U.S. bond to an eligible educational institution and the redemption of such a bond by an eligible educational institution.

Definitions

A qualified U.S. savings bond means a U.S. savings bond issued at discount under 31 U.S. Code section 3105, after the date of enactment.

Higher education expenses means tuition and fees required for enrollment or attendance at an eligible educational institution, and fees, books, supplies, and equipment required for courses of instruction at an eligible educational institution. An eligible educational institution means (1) an institution of higher education described in section 1201(a) or 481(a) of the Higher Education Act of 1965, or (2) an area vocational education school as defined in subparagraph (C) or (D) of section 521(3) of the Carl D. Perkins Vocational Education Act, which is in any State (as defined in sec. 521(27) of such Act).

A dependent means any child of the taxpayer with respect to whom a deduction is allowed under section 151 for the taxable year.

Effective date

The provisions would apply to transfers of qualified U.S. savings bonds issued after the date of enactment.

S. 1662 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

Authority to issue bonds

S. 1662 would authorize the Treasury to issue educational savings bonds, in addition to the other forms of U.S. savings bonds. As is the usual case with Series EE savings bonds, the interest on educational savings bonds would be accrued until redemption, which could not occur less than 12 months, nor later than 20 years, after issuance. The bonds would not be transferable.

When issued, an educational savings bond would bear interest at a rate equal to the Federal long-term rate (i.e., for debt with more than nine years to maturity) in effect at the time. The rate could be adjusted upwards from the rate in effect at the time of issue from time-to-time to reflect the differential between such rate and the rate on other debt obligations issued by the Treasury.

Interest exclusion from

Under the bill, a taxpayer could purchase annually for the benefit of a dependent up to $1,000 of educational savings bonds on which interest would accrue tax-free.

Interest or investment yield on an educational savings bond would be included in the gross income of the taxpayer for the taxable year in which the bond is redeemed only to the extent that the amount of such interest exceeded the sum of the higher education expenses paid or incurred by the taxpayer with respect to a dependent for that taxable year, or if the bond was redeemed more than 25 years after the date of its issuance. This limitation would not to apply for any taxable year during which the educational savings bond is redeemed if the registered owner is disabled or the taxable year is ended by the death of the registered owner.

Definitions

Higher education expenses.—This term means expenses at any eligible educational institution for tuition and fees for enrollment or attendance; fees, books, supplies, and equipment required for courses of instruction; and a reasonable allowance for meals and lodging while in attendance.

Eligible educational institution.—This term means (1) an institution of higher education as described in section 1201(a) or 481(a) of the Higher Education Act of 1965, or (2) an area vocational education school as defined in subparagraph (C) or (D) of section 521(3) of the Carl D. Perkins Vocational Education Act which is in any State (as defined in sec. 521(27) of such Act).

Effective date

The provisions would apply with respect to taxable years beginning after December 31, 1986.

Administration proposal

The President's budget proposals for fiscal year 1989 include a recommendation to exclude from gross income the interest on certain U.S. savings bonds that are redeemed to pay certain post-secondary educational expenses of the taxpayer or the taxpayer's spouse, children, or other dependents.

The exclusion would be phased out for taxpayers with adjusted gross income above certain levels; the phase-out levels would be adjusted annually for inflation beginning in 1990. The amount of interest eligible for the exclusion would be limited to the total qualified educational expenses incurred. The Administration has not yet forwarded to the Congress a more detailed explanation of this proposal.

The exclusion would apply to bonds issued after December 31, 1988.

B. Education Savings Accounts

Present Law

Present law does not provide a specific deduction for amounts contributed to a trust to fund educational expenses of the taxpayer or a child of the taxpayer.

Education expenses that qualify as trade or business expenses under section 162 generally are deductible. Expenditures made by an individual for his or her own education generally are deductible if incurred for education that (1) maintains or improves skills required by the individual's current employment or other trade or business, or (2) meets the express requirements of the individual's employer or the requirements of applicable law or regulations imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation (Treas Reg. sec. 1.162-5(a)). In the case of an employee, such expenses (if not reimbursed by the employer) are deductible only to the extent that, when aggregated with other miscellaneous itemized deductions, they exceed two percent of the taxpayer's adjusted gross income.

Under prior law, educational assistance provided by an employer to employees pursuant to an educational assistance program meeting certain requirements was excludable from the employee's gross income or wages for income or employment tax purposes (sec. 127). This exclusion expired for taxable years beginning after December 31, 1987.

Explanation of Proposals

S. 1533 (Senator DeConcini)

In general

Under S. 1533, an above-the-line deduction would be allowed (up to certain limits) for amounts paid in cash during the calendar year to an education savings account for the benefit of an eligible individual. (An education savings account could not be established for the benefit of more than one individual.) No deduction would be allowed for contributions to an account for the benefit of an individual who reached age 19 before the close of the year.

The deduction would be limited to the lesser of (1) $1,000 or (2) the compensation (earned income in the case of a self-employed individual) includible in the taxpayer's gross income for the year. In addition, the deduction would be reduced for taxpayers with adjusted gross income (AGI) above certain levels, similarly to the phase-out of the IRA deduction. The phase-out would begin at AGI of $40,000 in the case of a married couple filing a joint return, $25,000 in the case of an unmarried individual, and zero in the case of a married couple filing separate returns.

Contributions made to an education savings account by the due date of the taxpayer's return would be deemed to have been made on the last day of the prior year.

Requirements

Under the bill, an education savings account would have to satisfy the following requirements: (1) aggregate contributions in excess of $1,000 for one year could not be accepted; (2) the trustee must be a bank or other person who would administer the trust in accordance with the requirements of the bill; (3) trust assets could not be invested in life insurance contracts unless certain requirements are satisfied; (4) the taxpayer contributing to an account generally would be permitted to direct the investments of the account; (5) the assets of the trust could not be commingled with other assets except in a common trust fund or common investment fund; and (6) any balance in the account remaining when the individual for whom the account was established attains age 27 (or, if earlier, when such individual dies) must be distributed proportionately to the taxpayers who have contributed to the account.

The account could be established only to fund educational expenses, defined to mean expenses incurred at an eligible institution for (1) tuition and fees, (2) fees, books, supplies, and equipment required for courses, and (3) a reasonable allowance for meals and lodging. An eligible educational institution means an institution of higher education (within the meaning of secs. 1201(a) or 481(a) of the Higher Education Act of 1965) or a vocational school (within the meaning of secs. 521(3)(C) or 521(3)(D) of the Carl D. Perkins Vocational Education Act).

Tax treatment of distributions

Under the bill, except in the case of distributions used exclusively for education expenses of the individual on whose behalf the account was established, any amount paid or distributed from an education savings account is included in the gross income of the taxpayer who contributed to the account, in the same proportion as the taxpayer's contribution bears to total contributions to the account. An exception would be provided for certain contributions in excess of the deductible limit returned before the due date of the taxpayer's tax return for the taxable year of the contribution.

In addition, an additional income tax of 10 percent would apply if a distribution from an education savings account is not used in connection with the payment of educational expenses, unless the distribution is made after the death or disability of the individual on whose behalf the account was established.

Tax treatment of accounts

An education savings account generally would be exempt from Federal income tax, but would be subject to the tax on unrelated business income of exempt organizations (sec. 511). An education savings account would cease to be exempt from taxation if (1) the account engages in a prohibited transaction (within the meaning of sec. 4975) or (2) the individual on whose behalf the account is established pledges all or any portion of the account as security for a loan.

Gift tax treatment

The bill provides that contributions made by a taxpayer to an education savings account would not be treated as a gift of a future interest in property to the extent that the contributions are deductible by the taxpayer.

Reporting requirements

The trustee of an education savings account would be required to make such reports as may be required by Treasury regulations. A $50 penalty would be imposed for each reporting failure unless shown to be due to reasonable cause.

Effective date

The bill would be effective for taxable years beginning after December 31, 1986.

S. 1659 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

In general

This bill includes provisions for educational savings accounts that generally are the same as the provisions in S. 1533, as described above, with the following exceptions.

S. 1659 would provide a 15-percent tax credit, rather than a deduction, for contributions up to $1,000 per year to an educational savings account. The maximum amount allowable in one year as a credit would be $150, allocated proportionately among the taxpayers contributing to the account; the limitation would be indexed for inflation. Under S. 1659, contributions to the account could be made in cash or in the form of stocks, bonds, or other securities, if such stocks, etc., are readily tradeable on an established securities market.

Under S. 1659, as under S. 1533, an individual could not be the beneficiary of more than one education savings account. The bill provides that no credit would be allowed for a contribution to an education savings account if, before the close of the year in which the contribution is made, the beneficiary has attained age 21 or begun attendance at an eligible educational institution. Any balance remaining when the individual for whom the account was established attains age 25 (rather than age 27, as under S. 1533) or, if earlier, dies is required to be distributed proportionately to the taxpayers who have contributed to the account.

Tax treatment of distributions

Under S. 1659, the gross income of a beneficiary of an education savings account would be increased by 10 percent of the amounts paid or distributed from the account that were used exclusively to pay the educational expenses incurred by the beneficiary, for the taxable year in which the beneficiary attains age 25 and in each of the following nine taxable years. If the amounts credited to the account are not used for educational purposes, then, as under S. 1533, amounts distributed from the account are includible in the gross income of the recipient and are subject to an additional 10-percent income tax.

Tax on excess contributions

Under S. 1659, in the case of contributions to an education savings account that exceed the allowable contributions, the excess contributions would be subject to the excise tax on excess contributions to an individual retirement account (sec. 4973).

S. 1660 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

This bill is the same as S. 1659 except that no credit or deduction would be allowed for contributions to an education savings account. Earnings on amounts contributed to such an account generally would be excluded from income unless distributed for noneducational purposes.

S. 1661 (Senators Dole, Chafee, Danforth, Durenberger, Heinz, and Wallop)

This bill is the same as S. 1659 except that, for each taxable year, a 15-percent tax would be imposed on the taxable income of an education savings account, i.e., the gross income of the account minus any deductions directly allocable to such income.

C. National Education Savings Trust

Present Law

Under present law, there is no provision that permits deductions for amounts contributed to a trust to fund education expenses of the taxpayer or a child of the taxpayer.

Explanation of Proposal

S. 1572 (Senators Pell, Kennedy, and Stafford)

In general

Under S. 1572, a taxpayer would be allowed an above-the-line deduction for certain amounts paid in cash pursuant to an advance tuition payment plan agreement entered into between the taxpayer and the National Education Savings Trust (the "Trust"), a public corporation established by the bill. Payments made by the taxpayer would be placed into a fund managed by the Trust to provide for future postsecondary education expenses (at a public or private institution) of a qualified beneficiary designated by the taxpayer. Amounts paid by the Trust to meet a qualified beneficiary's expenses at a postsecondary educational institution would not be includible in the taxpayer's income or the beneficiary's income.

Deduction limitations and phaseout

A taxpayer would be permitted to enter into more than one advance tuition payment plan agreement to provide for future educational expenses of more than one qualified beneficiary. However, the bill limits the amount a taxpayer could pay to the Trust under each advance tuition payment plan for each qualified beneficiary to $2,000 for any taxable year, and $48,000 for all years.

The bill further provides that amounts paid by a taxpayer to the Trust during the year would be deductible in full only if the taxpayer's adjusted gross income (AGI) for that year is not more than $25,000. If the taxpayer's AGI is more than $25,000 but not more than $60,000, then 50 percent of the amount paid to the Trust would be deductible. If the taxpayer's AGI is more than $60,000 but not more than $100,000, then 25 percent of the amount paid to the Trust would be deductible.[2] These amounts would be indexed for inflation beginning after 1988.

A taxpayer with AGI exceeding $100,000 would not be allowed any deduction for amounts paid to the Trust during that year. However, income earned on nondeductible payments to the Trust would still be tax-free, provided that such income is used to pay for postsecondary education expenses of a qualified beneficiary.[3]

The bill requires that the beneficiary of an advance tuition payment plan agreement must already have been born and must be either the taxpayer who entered into the agreement or a dependent of the taxpayer (within the meaning of Code sec. 151). In addition, no deduction would be allowed for payments made to the Trust if: (1) the beneficiary dies or attains age 30 during the year; (2) the taxpayer making the payment is a dependent of any other person; or (3) the beneficiary is the spouse of the taxpayer, unless the taxpayer and spouse file a joint return for the year the deduction is claimed.

Deductions for amounts paid to the Trust would be allowed whether or not the taxpayer itemizes deductions. A taxpayer would be deemed to have made a payment to the Trust on the last day of the preceding year if such payment is made on account of the preceding year and is made by the due date for filing the taxpayer's return for that year.

Benefits furnished by the Trust

The bill provides that payments from the Trust to a postsecondary education institution pursuant to an advance tuition payment plan agreement would not be included in the gross income of any person. Any amount disbursed by the Trust which is not paid to a postsecondary education institution, including amounts refunded to the taxpayer on termination of the agreement (as described below), would be included in the gross income of the person receiving the payment and would be subject to income tax. Also, the recipient would be subject to a penalty equal to 20 percent of the amount received (10 percent if the beneficiary has not attained the age of 25 in the year the payment is made by the Trust). The penalty would not apply, however, if a payment is made to a person other than a postsecondary education institution by reason of the death of the beneficiary under an advance tuition payment plan agreement.

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[2] In the case of a married taxpayer filing a separate return, 100 percent of the amount paid to the Trust would be deductible only if the taxpayer's AGI is not more than $12,500; 50 percent of the amount paid, if the taxpayer's AGI is more than $12,500 but not more than $30,000; and 25 percent of the amount paid, if the taxpayer's AGI is more than $30,000 but not more than $50,000. A married taxpayer filing a separate return would not be allowed a deduction for payments made to the Trust if the taxpayer's AGI exceeds $50,000.

[3] While not explicitly stated, the bill apparently assumes that the Trust is not subject to Federal income tax.

The term postsecondary education institution means an institution of higher education as described in section 1201(a) of the Higher Education Act of 1965.

Termination of plan agreements

An advance tuition payment plan would be terminated if (1) the beneficiary dies; (2) the beneficiary attains the age of 30; (3) the taxpayer certifies to the Trust that the beneficiary, after attaining the age of majority, has decided not to attend a postsecondary education institution or has completed as much of the course of postsecondary education as the qualified beneficiary intends to complete; or (4) other circumstances determined by the Trust and set forth in the agreement.[4] Upon termination of the agreement, the Trust would be required to refund to the taxpayer the face amount of the payments or installments, plus any interest or dividends accrued thereon. The refund would be disbursed by the Trust to the taxpayer in a single payment and would be reported to the IRS.

Board of Trustees

With respect to the Trust, the bill would create a Board of Trustees composed of: (1) the Secretary of Education and the Secretary of the Treasury; (2) five representatives of postsecondary education institutions and five members of the general public, appointed by the President with the advice and consent of the Senate;[5] and (3) one chairman, appointed by the President with the advice and consent of the Senate.[6]

The Secretary of the Treasury would be the Managing Trustee of the Board with respect to managing the assets of the Trust, which could be invested only in interest-bearing obligations of the United States or in obligations guaranteed as to both principal and interest by the United States.

The Board would be required to report to Congress on an annual basis on the operation and status of the Trust during the preceding fiscal year and on its expected operation and status during the next five years.

Effective date

The amendments to the Internal Revenue Code made by the bill would apply to taxable years ending after the date of enactment.

D. Deduction for Interest on Education Loans

Present Law

Pursuant to the Tax Reform Act of 1986, the itemized deduction for personal interest is being phased out over 1987-1990 and will be wholly disallowed after 1990 (Code sec. 163(h)). Personal interest is any interest *other than* interest incurred in connection with a trade or business (other than of performing services as an employee), investment interest, interest taken into account in computing the taxpayer's income or loss from passive activities, qualified residence interest, or interest on certain deferred estate tax.

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[4] The bill provides that the agreement may permit the taxpayer, with the approval of the Trust, to substitute another qualified beneficiary for the qualified beneficiary originally named, in lieu of termination of the agreement.

[5] These representatives and members would generally be eligible to serve no more than two terms of four years each.

[6] The chairman would be appointed for a term of five years and would not be eligible for reappointment.

Qualified residence interest, which is not subject to the limitation on personal interest, is interest on debt secured by a security interest valid against a subsequent purchaser on the taxpayer's principal residence or a second residence of the taxpayer. For taxable years beginning in 1987, interest on such debt was generally deductible to the extent that the debt did not exceed the amount of the taxpayer's basis for the residence (including the cost of home improvements).

In addition, the law for 1987 allowed a taxpayer to deduct as qualified residence interest the interest on certain loans incurred for qualified educational or medical expenses up to the fair market value of the residence. For this purpose, qualified educational expenses meant reasonable living expenses while away from home, and any tuition and related expenses that would qualify as scholarship (under sec. 117(b)), for the taxpayer, a spouse, or dependent, while a student at an educational institution. Thus, tuition expenses for primary, secondary, college, and graduate level education were generally included in qualified educational expenses. The qualified educational expenses must have been incurred within a reasonable period of time before or after the debt was incurred. Reimbursed expenses were not treated as qualified educational expenses.

For taxable years beginning after 1987, the Revenue Act of 1987 amended the definition of qualified residence interest that is treated as deductible. Under the 1987 Act, qualified residence interest includes interest on acquisition indebtedness (up to $1 million) and home equity indebtedness (up to $100,000) with respect to a principal and a second residence of the taxpayer. No special rules apply to education or medical loans.

Explanation of Proposal

S. 628 (Senators Grassley, Danforth, D'Amato, Kerry, Durenberger, and Hecht)

S. 628 provides that interest on a qualified education loan would be deductible as an itemized deduction. A qualified education loan would be defined as indebtedness incurred to pay qualified educational expenses if such expenses are paid or incurred within a reasonable period of time before or after the indebtedness is incurred. Qualified educational expenses would have the same meaning as under the law relating to qualified residence indebtedness as in effect in 1987 (described above).

The bill would be effective for taxable years beginning after December 31, 1986.

E. Employer-Provided Educational Assistance

Present Law

General rules

Under present law, an employee must include in income and wages, for income and employment tax purposes, the value of educational assistance provided by an employer to an employee, unless the cost of such assistance qualifies (under sec. 162) as a deductible job-related expense of the employee. Amounts expended for education qualify as deductible job-related expenses if the education (1) maintains or improves skills required for the employee's current job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continued employment (Treas. Reg. sec. 1.162-5(a)). In the case of an employee, such expenses (if not reimbursed by the employer) are deductible only to the extent that, when aggregated with other miscellaneous itemized deductions, they exceed two percent of the taxpayer's adjusted gross income. No deduction is allowed for expenses incurred to qualify for a new trade or business (e.g., for law school tuition paid by a paralegal or accountant).

Under prior law, an employee's gross income and wages for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (sec. 127). This exclusion, which expired for taxable years beginning after December 31, 1987, was limited to $5,250 of educational assistance with respect to an individual during a calendar year.

Section 127 required, among other things, that educational assistance provided under such a program not discriminate in favor of highly compensated employees in certain respects. The Statement of Managers for the Tax Reform Act of 1986 indicated that if the section 127 exclusion for educational assistance were extended, the new nondiscrimination rules for employee benefits added by the 1986 Act (sec. 89) were to be applied to the exclusion in lieu of the prior-law rules.

In 1984, Congress required that employers file information returns with respect to educational assistance programs under section 127 (sec. 6039D). This requirement is intended to collect data with respect to the use of such programs so that Congress may evaluate the effectiveness of the exclusion.

Tuition reduction for graduate teaching assistants

Pursuant to section 127(c)(8) (prior to its expiration), the exclusion under section 117 relating to qualified tuition reductions was made applicable with respect to graduate-level courses in the case of graduate teaching or research assistants at colleges or universities. Under the section 117 rules, as amended by the Tax Reform Act of 1986, the amount of qualified tuition reduction provided to an employee of an educational institution is includible in gross income and wages to the extent the tuition reduction constitutes payment for teaching, research, or other services (sec. 117(c)). Any amount of qualified tuition reduction (up to the amount of tuition) in excess of such payment may qualify for exclusion pursuant to section 117(d).

By virtue of the expiration of section 127, no amount of tuition reduction for graduate-level courses is excludable under section 117(d)(2) for 1988 or later years.

Explanation of Proposal

S. 39 (Senators Moynihan, Heinz, Boren, Pryor, Matsunaga, and Riegle)

S. 39 would reinstate the section 127 exclusion on a permanent basis, effective as of the termination date of the prior-law exclusion.

F. Certain Student Loan Bonds

Present Law

Purposes for which tax-exemption permitted

Interest on State and local government bonds to finance activities of those governmental units generally is tax-exempt (Code sec. 103). Interest on private activity bonds is taxable unless a specific exception is provided in the Internal Revenue Code. Private activity bonds are bonds that satisfy one or both of (1) a private business use and private payment test and (2) a private loan test. One of the purposes for which tax-exempt private activity bonds may be issued is the financing of student loans.

Tax-exempt student loan bonds may be issued in connection with the Federal Government's Qualified Student Loan (GSL) and Parent's Loans for Undergraduate Students (PLUS) programs. Student loan bonds issued in connection with the GSL and PLUS programs are Federally guaranteed, and in the case of GSL bonds, receive a Federal interest subsidy beyond tax-exemption, so-called "special assistance payments." The Federal Government imposes limits on the incomes of individuals who may receive loans financed with bonds issued in connection with these Federal programs.

Since 1986, tax-exempt student loan bonds also may be issued to finance State supplemental student loan programs. These programs are not subject to the income limits applicable to Federally guaranteed student loan bonds.

Qualified issuers of tax-exempt bonds

In general, tax-exempt bonds must be issued by or "on behalf of" a State or local government. In addition, student loan bonds issued in connection with the GSL and PLUS programs may be issued directly by a "qualified scholarship funding corporation." A qualified scholarship funding corporation is a not-for-profit corporation organized exclusively for the purpose of issuing student loan bonds to acquire student loan notes incurred under the Higher Education Act of 1965. Qualified scholarship funding corporations may not issued supplemental student loan bonds.

Arbitrage restrictions

All governmental and private activity bonds must satisfy restrictions on the amount of arbitrage profits that may be earned and retained for the interest thereon to qualify for tax exemption. In general, these restrictions limit the period in which bond proceeds may be invested in materially higher yielding investments to (1) certain prescribed temporary periods and (2) amounts invested as part of a reasonably required reserve or replacement fund.

Bonds issued as a pooled financing (e.g., bonds used to make loans to multiple parties) generally are limited to an initial temporary period of six months. A special exception applies to student loan bonds issued in connection with the Federal GSL and PLUS student loan programs. These bonds are eligible for an 18-month initial temporary period when bond proceeds may be invested in materially higher yielding investments. This special exception, enacted in 1986, is scheduled to expire with respect to bonds issued after December 31, 1988.

Issuers of all governmental and private activity bonds generally must rebate to the Federal Government all arbitrage profits earned on investments of the bond proceeds that are unrelated to the governmental purpose of the issue. An exception permits retention of these arbitrage profits if all gross proceeds of the issue are spent for the governmental purpose of the issue within six months after the bonds are issued.

A special exception applies to student loan bonds issued in connection with the Federal GSL and PLUS student loan programs. Issuers of these bonds may retain arbitrage profits earned in the 18-month initial temporary period, described above, if the proceeds are used to pay administrative costs of the student loan program and costs of issuing the bonds. This exception applies only to the extent such costs are financed with the bond proceeds and only to the extent the issuer is not otherwise reimbursed. Interest payments by student borrowers are not treated as reimbursements for this purpose.

Additionally, under a special provision of Treasury Department regulations, costs paid from student-borrower interest payments are not taken into account in determining the yield on student loans. Thus, issuers of these student loan bonds may earn and retain an amount up to two times their administrative costs and costs of issuance without violating the present-law arbitrage restrictions. The special exemption from the arbitrage rebate requirement is scheduled to expire with respect to bonds issued after December 31, 1988.

Explanation of Proposal

S. 2149 (Senators Mitchell, Pryor, Durenberger, Boren, Danforth, and Rockefeller)

S. 2149 would make permanent the special 18-month initial temporary period when issuers of GSL- and PLUS-student loan bonds may invest bond proceeds in nonpurpose investments without regard to yield restrictions.

The bill also would make permanent the special exemption from the arbitrage rebate requirement under which issuers of these student loan bonds may retain arbitrage profits to pay administrative costs and costs of issuing the bonds.

Further, the bill would extend these two special exceptions to supplemental student loan bonds and also would authorize qualified scholarship funding corporations to issue supplemental student loan bonds.

The bill would be effective on the date of enactment.

III. ECONOMIC ANALYSIS

A. Education Savings Bonds; Education Savings Accounts; and National Education Savings Trust

A number of bills introduced in the 100th Congress would provide tax incentives for education by creating either education savings bonds (S. 1662 and S. 1817), education savings accounts (S. 1533, S. 1659, S. 1660, and S. 1661), or a national education savings trust (S. 1572). Each of these bills would provide tax incentives to encourage parents to save to finance the post-secondary education of their children. These bills would provide either deferral of, or exclusion from, tax for income that is used to finance qualified educational expenditures.

Deferral vs. exemption

Exempting income from taxation is always more valuable to the taxpayer than deferring taxation on the same income. For example, if $1,000 could be invested for 10 years to earn eight percent annually and those earnings were exempt from taxation, this investment would have accumulated $1,158.93 in interest by the end of the 10-year period. If the earnings instead were taxed annually to a taxpayer at the 28-percent marginal tax rate, the accumulated interest, net of taxes, would be $750.71 after 10 years. If the earnings were not taxed annually, but rather the tax was deferred for 10 years and assessed on the accumulated interest at the end of the 10-year period, the value of the taxpayer's net earnings would be $834.43. In this example, deferral increases the taxpayer's return by 11.2 percent over the 10-year period compared to annual taxation. Exemption is 38.9 percent more beneficial than deferral over the same period.

The benefit of tax exemption generally is greater to a higher-income taxpayer than a lower-income taxpayer, because the tax liability saved per dollar of Tax-exempt income is greater for taxpayers in higher tax brackets. The benefit of deferral depends not only on the taxpayer's current tax rate, but also on his or her future tax rate. The benefit of deferral is increased for a taxpayer who currently is taxed at a high marginal rate, but who can defer the tax liability until a lower marginal rate applies. The benefit of deferral is decreased if the taxpayer currently is taxed at a low marginal rate and defers the tax liability to a year when a higher marginal tax rate applies. In this circumstance, because of the taxpayer's low initial tax rate, the taxes deferred may actually be worth less than the taxes owed at the later date when the taxpayer is in a higher tax bracket.

Provisions of present law providing saving incentives

Present law contains various tax incentives for savings. While not earmarked for education, these incentives may provide the opportunity to save for education expenses. Given the existence of these tax-preferred savings instruments, some argue that additional savings incentives are not justified.

For example, the interest on qualified bonds issued by State and local governments is exempt from Federal income taxation. The interest on U.S. Series EE savings bonds is taxed on a deferred basis. Under certain circumstances, benefits accrued under a qualified pension plan may be borrowed or withdrawn to pay education expenses. Interest earned on a life insurance contract accrues annually (inside buildup). The interest income which has accrued to the policy is subject to taxation on a tax-deferred basis. The policy could be redeemed to pay education expenses. Alternatively, a loan against the cash surrender value of a life insurance contract can be used to pay education expenses, generally without current tax on the inside buildup. Parents can establish a trust under section 2503(c) the income of which may be taxed at lower marginal tax rates than the parents' rate; the trust can then be used to pay education expenses. In addition, assets may be shifted to children and receive the benefit of the children's lower marginal tax rates if the children are over 14 years old.

Others argue that the existing tax incentives are insufficient to encourage systematic, long-term saving for education expenses, which have risen rapidly in recent years (see Appendix, below). They argue that the national saving rate is too low and further inducements to save are warranted. Moreover, they argue that the economy would benefit from having a more educated, more skilled labor force. Incentives for education would induce more individuals to seek post-secondary education or training.

Who benefits from savings incentives for education?

The immediate beneficiaries of the tax incentives to save for education provided by the bills are parents who want to fund future education expenses of their children. By providing an exemption from income, or a deferral of tax liability, the bills generally would provide more benefit to higher-income taxpayers than to lower-income taxpayers. Individuals without any income tax liability would not receive any benefit from these proposals.

The recipients of the education also could benefit, because generally additional education or training increases an individual's earning potential. In addition, the recipients may benefit by completing their education with a smaller burden of debt than they otherwise would have incurred. However, some would argue that to the extent these incentives would not lead to more individuals enrolling in post-secondary education or training programs, there would be no benefit to the recipients since they would have obtained the training even if no such incentives were enacted

Some of the benefit of the incentives may accrue to the educational institutions and their employees, rather than to the taxpayers and their children. Some believe that such incentives, by increasing the demand for post-secondary education, would drive up the prices that educational institutions and their employees charge for their services. To that extent, higher prices could transfer the benefit from the taxpayer to the educational institution.

The benefit the parents may receive from tax exemption or deferral can significantly increase the rate of return on saving for education. This higher return might induce parents to save money for their children's education that they otherwise would not. If so, this inducement could increase the national saving rate, leading to greater economic growth.

Equity considerations

Some believe it is inappropriate to permit any taxpayer an exemption, full or partial, for interest on savings for education. Such a full or partial exemption is equivalent to a deduction for tuition costs. They argue that such a deduction more often benefits higher-income taxpayers than lower-income taxpayers, and that it is inappropriate to extend tax incentives to save to higher-income taxpayers because they already possess the means to save for their children's education without added inducement. Others argue that the costs of education have risen for everyone and that broadly applicable tax incentives are justified.

Benefits for higher-income taxpayers could be restricted in a number of ways. The amount of the annual contribution could be limited. For example, S. 1533 and S. 1572 limit the amount of annual contributions that may be deducted and phase out the deduction for higher-income taxpayers. Similarly, S. 1817 would not permit exemption of the earnings of education savings bonds for taxpayers with adjusted gross income in excess of $150,000, and would provide only partial exclusion for taxpayers with adjusted gross income between $75,000 and $150,000. However, even for these taxpayers, the benefit of tax deferral remains.

Credits for annual contributions, rather than deductions, could be utilized. For example, S. 1659 and S. 1661 would provide a tax credit for contributions made to an education savings account of the intended beneficiary. In general, a credit provides the same reduction in tax to all taxpayers regardless of their tax rate. Depending upon the size of the credit, the credit could be more or less generous than a deduction. However, deductions and credits, if not refundable, provide no benefit to individuals who have no tax liability.

Limiting the ability of higher-income taxpayers to benefit from exemption does not necessarily remove the benefit of deferral. S. 1662 would limit the annual tax deferral for all taxpayers to the deferral of the tax which would be due on no more than $1,000 of education savings bonds.

Some who believe that the benefit of the incentives accrues to the recipients of the education feel it is unfair that the recipient does not pay tax on at least a portion of the benefits received. They suggest that some of the benefits granted to current taxpayers should be recaptured from the taxpayers' children upon the completion of their education. For example, S. 1659, S. 1660, and S. 1661 each would recapture at least part of the benefits by adding to the taxable income of the child 10 percent of the benefits, in 10 equal installments starting in the year the child reaches age 25.

From a family's perspective, these bills would provide deferral of tax liability. However, from the parents' perspective, the benefit would be one of exclusion from income, because the deferred tax would be collected from the children. If the parents view the education savings account as full or partial exclusion, the bill would provide a clear incentive to establish these accounts. If the parents take the family perspective, the benefit of deferral depends, in part, upon the rate at which the tax is deferred and the rate at which the tax is ultimately due. Most typically, children are subject to lower tax rates upon their completion of post-secondary training than their parents face. When this is true, deferral can carry a substantial benefit. The benefit of deferral will be greater if the deferred amounts are taxed at a lower rate than the rate that would apply if such amounts were included in the parents' income. When the children are subject to higher tax rates than their parents, the benefit of deferral decreases but is not necessarily eliminated.

Some would view the concept of assigning the ultimate tax liability to the children as appropriate because it is the children who receive the benefit of the education. On the other hand, assigning the tax liability to the children may increase the financial burden of young individuals. For example, $50,000 in college expenses would be assigned to the child beginning at age 25. If the child is taxed at the 15-percent marginal tax rate, tax liability would be increased by $750 per year. The child would owe $1,400 per year in additional taxes at a 28-percent marginal rate. Some would argue that this is appropriate, since a higher income could result from a greater benefit received from education. However, since the typical case is for the parents' income to exceed their children's income, this would be a regressive shift of the tax burden.

An additional consideration in taxing the educational benefit to the child is administrative complexity. One or more taxpayers may contribute to the account of a single beneficiary; the taxable portion of the benefits must be traced to the beneficiary at age 25, which is three years beyond the age at which the average college student graduates. Distributions not expended on education create a tax liability for the contributors. This could create significant enforcement burdens for the IRS, which would be required to identify the contributors to whom the tax liability applies and the portion of liability applicable to each contributor.

Savings incentives for education and the national savings rate

Some argue that, as a nation, we save too little. All the above-described bills would increase the after-tax return for savings, thereby making saving a relatively more attractive option than current consumption. As a result, the taxpayer may choose to save more. However, if the taxpayer saves with certain goals or target amounts in mind, increasing the net return to saving could lead the taxpayer to save less because the same amount could be saved with a smaller investment of principal. For example, a taxpayer in the 28-percent marginal bracket may set aside $1,300 today to help defray tuition expenses 15 years from now. If the taxpayer's investment earns eight percent annually and those earnings are taxed annually, 15 years from now his investment will be worth $3,000. If the taxpayer could defer the tax owed on the earnings for 15 years, an investment of only $1,025 today would be worth $3,000 15 years from now. Empirical investigation of the responsiveness of personal saving to after-tax returns provides no conclusive results. Some find personal saving responds strongly to increases in the net return,[7] while others find little or a negative response.[8]

Creating new tax-favored saving arrangements does not necessarily create new saving. The higher net return and the increased awareness of the need to save for college expenses which could arise from the private market advertising for education savings accounts or the sale of education savings bonds could induce taxpayers to save more. On the other hand, the taxpayer might merely transfer existing savings accounts into a tax-advantaged education account. The proposed structure for education savings bonds, education savings accounts, and the education savings trust is similar in structure to present-law deductible and nondeductible individual retirement accounts ("IRA"). Some believe that IRAs have been responsible for new saving, i.e., saving which would not otherwise have occurred.[9] Others argue that IRAs have for the most part been financed by taxpayers either shifting funds from their existing holdings of securities into IRAs, or by placing in IRAs funds which they would have saved anyway.[10] In addition, it would be possible to finance the account with borrowed funds, in which case no net saving would occur. If a home equity loan were used, the interest on the borrowed funds would be deductible as well.

As discussed above, some of the bills would limit the ability of higher-income taxpayers to utilize fully all of the incentives. Experience with IRAs prior to the restrictions imposed by the Tax Reform Act of 1986 on contributions by higher-income individuals indicated that although many lower-income individuals contributed to IRAs, the percentage of participation was greatest among higher-income taxpayers. Higher-income taxpayers made larger contributions as well. Taxpayers with adjusted gross incomes in excess of $50,000 constituted approximately 29 percent of all IRA contributors, but accounted for more than 35 percent of 1985 IRA contributions.

Distributions for expenses other than education

It may be possible for taxpayers to use these incentives to accumulate more funds than they need to meet post-secondary education expenses. The bills establishing education saving accounts or the National Education Saving Trust would include in the income of the contributors their pro rata share of any distributions from the accounts which are not spent on qualified education expenses. In addition, each bill would provide for an additional 10-percent income tax on such distributions to recapture partially the tax benefit or deferral for such distributions. S. 1572 would increase the additional tax to 20 percent if the distribution occurs after the named beneficiary's 25th birthday.

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[7] *See* M. Boskin, "Taxation, Saving, and the Rate of Interest," *Journal of Political Economy*, April 1978, 86.

[8] *See* G. von Furstenberg, "Saving," in H. Aaron and J. Pechman (eds.), *How Taxes Affect Economic Behavior*, Brookings Instiution, 1981.

[9] *See*, Venti, Steven F. and David A. Wise, "The Evidence on IRAs," *Tax Notes*, vol. 38, January 25, 1988, pp. 411-16.

[10] *See*, Galper, Harvey and Charles Bryce, "Individual Retirement Accounts: Facts and Issues," *Tax Notes*, vol. 31, June 2, 1986, pp. 917-21.

Establishing an account or buying education saving bonds could be advantageous for taxpayers even if they have no intention of funding post-secondary education for their children. This is because of the benefit of tax deferral that the accounts would provide. For example, for a taxpayer with a 28-percent marginal tax rate, $1,000 of income would leave $720 available after tax to be saved. If this amount is invested to earn eight percent annually and the earnings are taxed annually, at the end of 10 years the taxpayer will have $1,260.51. If, however, the taxpayer can deduct the $1,000 and accumulate the interest tax-free, at the end of 10 years he or she will have $2,158.93. After including the distribution in income, subject to the additional 10-percent tax, the taxpayer would net $1,338.54 (six percent more than if the account had not been used). The result would be different if the initial contribution is not deductible.

In both S. 1662 and S. 1817, the education savings bonds would be registered to the purchaser. The purchaser need not have children to buy the bond. If not used for qualified education expenses, the proceeds would be taxed as ordinary income in the year in which the bond is redeemed. These bonds could become vehicles for saving for purposes other than financing education, because they offer any taxpayer the advantage of tax deferral on his or her investment. While an IRA currently offers the benefit of tax deferral, a penalty is imposed for withdrawal before retirement age. As a result, these bonds should be a more preferred saving instrument.

S. 1662 would moderate this potential effect by limiting the annual tax deferral to interest on the first $1,000 of such bonds. In addition, S. 1662 would require that no interest be paid on any bond held longer than 20 years. On the other hand, S. 1662 would exempt from taxation the accumulated interest if the taxpayer died or became disabled. To the extent that taxpayers use these bonds as a general saving instrument at the expense of Federal revenues, they could operate as an inefficient means of aiding education.

Some might argue that providing the tax benefit of deferral when the proceeds are not spent on education is inappropriate. The penalties in the bills may be sufficient to keep taxpayers from using these tax preferred instruments for expenses other than education. However, the penalties also could discourage taxpayers from using these instruments. Many high school graduates do not go on to college or other formal post-secondary training. If parents established these tax-preferred accounts or purchased education savings bonds, they would not know if their children will gain admittance to college. If their children do not enroll in a post-secondary education program, the parents would be subject to the penalties. Depending upon the size of the potential penalties compared to the tax saving, this could create a financial risk the parents would not want to assume. This could lead to the accounts being established by those who are most sure that their children will be going on to college. These parents are also most likely to save for college expenses in the absence of tax incentives.

On the other hand, parents who establish accounts might more readily encourage their children to seek post-secondary training. This additional training could be valuable to the economy as a whole.

Other issues in saving for post-secondary education

Investment of the account or trust monies

S. 1533, S. 1659, S. 1660, and S. 1661 would create individually directed saving accounts. The contributor could direct the trustee to invest in stock, bonds, etc. S. 1572, S. 1662, and S. 1817 would require that proceeds be invested in Federal securities or Federally backed securities. Typically, Federal securities generate lower average earnings than corporate stock or other financial instruments. Some would argue that restricting investment to lower-earning securities would diminish the incentive effect of a savings plan. In addition, they argue that freedom of choice would allow parents to earn higher yields and thereby more easily accumulate the necessary funds to meet post-secondary education expenses.

On the other hand, Federal securities are risk-free. Funds saved for education through Federal securities are assured of having their full face value plus accumulated interest available for future education expenses. The stock market and other investments are inherently risky and neither principal nor earnings are assured; thus, parents could accumulate less money than needed for their children's education.

For many taxpayers, the interest on the education savings bonds would be exempt from tax, or at least are more favorably taxed than other income. At the same time, the interest the bonds would pay could be significantly higher than that offered by existing tax-exempt bonds.[11] If so, such bonds would provide strong direct competition for the municipal bond market. This could force States and municipalities to offer higher yields to attract lenders, thereby increasing borrowing costs of State and local governments.

Other financial aid

Children of parents who have not accumulated sufficient funds to pay for college expenses are often eligible for other financial aid, either private or governmental (see the Appendix, below, for information on Pell grants, Perkins Loans, Guaranteed Student Loans, etc.). In general, eligibility for this aid depends upon parents' current income and parents' accumulated assets. The greater the parents' income and the greater their accumulated assets, the less likely the student will qualify for financial aid. Reducing the amount or likelihood of Federal or other aid to the student imposes an implicit tax on the accumulation of assets. This might reduce the effectiveness of these bills in stimulating saving for college education.

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[11] Under S. 1662, the bonds would pay the Federal long-term rate. S. 1817 does not authorize the Treasury to issue a new series of bonds, but rather would permit purchasers to qualify by purchasing any existing Treasury issue. The Treasury currently issues, as Series EE bonds, bonds whose interest earnings are not taxable until the bonds are redeemed. Thus, the existing Series EE bonds provide the benefit of deferral.

S. 1572 explicitly would require that the proceeds of an educational savings trust not be included in any computation of Federal, State, or private financial aid. While this removes the implicit penalty on accumulation, it also means that certain programs designed to aid lower-income families may be opened to high-income families.

Some would argue that it is appropriate to ask those who are wealthier to assume a greater burden of the expense of education from their own sources. Others would respond that this encourages people not to save for their children's education but rather to rely on subsidies provided by Federal, State and private programs, and it unfairly burdens those parents who do sacrifice to save for their children's education.

Definition of education expense

In general, the bills would provide savings incentives for amounts of qualified education expenses, including tuition, fees, and reasonable room and board expenses. S. 1817 would exclude expenses for room and board. Some would argue that since parents would provide for their children's room and board if they did not go away to school, it is inappropriate to provide tax benefits for these expenses; also, it can be argued that these are not expenses incurred directly for education purposes. In addition, they argue it would be unfair because parents whose children continue to live at home do not receive the same benefit. On the other hand, expenses for room and board typically cost more if one lives away from home. For children who do not attend a local college, such expenses are necessary if they are to receive the post-secondary training.

B. Deduction for Interest on Education Loans

S. 628 would permit the full amount of interest on qualified education loans to be deducted by individuals as an itemized deduction. To the extent deductibility reduces the cost of debt associated with education expenses, this provision may reduce the cost of education and thereby make college more affordable to a greater number of individuals. Also, it is argued that student loans often impose a heavy burden on graduates at the beginning of their careers; interest deductibility under the bill may ameliorate this burden.

S. 628 would reduce education costs only to the extent that debt is incurred. Because the bill may reduce the effective cost of debt relative to other financing methods, opponents may argue that interest deductibility might encourage students to assume additional debt instead of using current earnings or previous savings for education expenses.

Further, it is argued that the deductibility of student loan interest might benefit predominantly middle- and upper-income taxpayers, since college graduates generally earn higher levels of income than individuals who do not attend college. Because educational loan interest would only be deductible by itemizers, and the percentage of individuals who itemize increases with income, higher-income taxpayers may benefit more than lower-income individuals. In addition, the value of the deduction would be greatest for taxpayers in the highest bracket. Also, the highest level of loans generally would be obtained by students who continue on with professional or graduate education and who typically would have the highest income levels during the repayment period.[12]

On the other hand, some argue that the benefits of deductibility would accrue more to lower- and middle-income individuals because higher-income individuals may not need to borrow to finance education costs. To the extent that higher-income students would borrow to take advantage of the deduction while spending their resources on other goods or services, however, this argument may not be as persuasive.

Some believe that interest deductibility is desirable to alleviate the excessive burden that student loan repayments place on some graduates.[13] To the extent any excessive burden stems from low income or unemployment rather than high levels of debt, the effect of deductibility of interest payments might provide limited relief.

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[12] The Guaranteed Student Loan (GSL) program limits aggregate loans at $17,250 for undergraduates and $54,750 for graduate and professional students.

[13] For 1984 graduates of four-year educational institutions with educational debt and who held full-time jobs the year after graduation, a third had debt repayments amounting to more than six percent of pre-tax income in the first year of repayment. Ten percent of the graduates had repayments greater than 10 percent of income. See Cathy Henderson, "College Debts of Recent Graduates," American Council on Education, December 1987.

For Federally subsidized loans, a reduction in repayment rates or increased deferments might be of greater value in reducing the burden on lower-income graduates than would interest deductibility.[14] Similarly, some argue that high debt levels and correspondingly high after-tax interest payments prevent graduates from accepting lower-paying public service jobs.

Individuals who incurred debt for educational purposes prior to the Tax Reform Act of 1986 may have expected to be able to deduct interest charges when the debt was to be repaid. Some consider the phase-out of the personal interest deduction enacted in 1986 as placing an unfair, additional burden on these individuals that could not have been expected when the debt was incurred. Others respond, however, that the phase-out applies to interest on all personal debt, not just that on student loans.

According to one study, 43 percent of graduates of four-year institutions of higher education in 1984 had borrowed money for educational expenses.[15] Of 1984 graduates who borrowed funds, the average indebtedness was $5,470. For the average debtor, interest deductibility under the bill would reduce the net-of-tax loan repayment cost by a maximum of $72 in any year when compared to present law; the maximum present value reduction in the total cost of education from the year of enrollment would be under $350.[16]

In another example, a 1987 college graduate who had accumulated the four-year GSL maximum total debt of $13,250 (under present law) would receive, from the enactment of S. 628, no more than $200 of tax benefits in any year; the present value of the tax benefits due to the bill would be less than $1,050. Likewise, the average 1987 entering freshman who borrows for educational purposes is projected to accumulate a total educational debt of $11,360.[17] The tax benefit for this 1991 graduate would not exceed $250 in the first year of repayment, while the present value of the tax benefits would be under $1,200. If the student is not able to itemize for some years of debt repayment, the benefit might be significantly lower.

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[14] The GSL program already provides several deferments, including up to two years due to unemployment and for periods of additional study.

[15] The data in this paragraph are based on an analysis of the Department of Education "1985 Recent College Graduate Survey" presented in Henderson, *supra*. The analysis omits graduates who were at the time enrolled in a further degree program.

[16] These calculations assume a nominal interest rate on the loan of eight percent, that debt is treated as a GSL with deferment until six months after graduation and a ten-year repayment period, and that in each repayment period year the borrower itemizes and is in the 28-percent marginal tax bracket. It also is assumed that the borrower graduates in four years. Present values are are calculated using a five-percent annual discount rate and using the initial year of enrollment as the base year. This makes the present value amounts comparable to total college costs discounted to the freshman year.

[17] This projection is based on an 11-percent growth in the average 1984 graduate debt level (See Henderson, *supra*).

C. Employer-Provided Educational Assistance

S. 39 would reinstate the prior-law exclusion (sec. 127 of the Code) from income and employment taxes for employer-provided educational assistance; this exclusion expired at the end of 1987. Under present law, the value of employer-provided education that relates directly to the taxpayer's current job remains excludable; however, the value of expenses of training for a new job or occupation is not excludable.

The prior-law exclusion for employer-provided educational assistance can be viewed as a means for advancing the goal of increased educational opportunities. In this view, encouraging employers to retrain employees for new jobs or careers is an efficient means to increase the skills and productivity of the workforce. Education which employers provide is more likely to be of direct economic value to both the employee and the firm. Some believe, however, that the most useful employer-provided expenditures already are excludable as job-related education expenses.

Some also could argue that the prior-law exclusion provided tax benefits in an unfair manner. An individual who incurred non-job-related education expenses directly would not be entitled to a deduction for such expenses, while an individual covered by an employer-provided plan would be able to exclude from income the same expenses.

Compared to the excludability of job-related expenses, an exclusion for all employer-provided educational assistance arguably provides a greater benefit to less-skilled individuals. Higher-income, higher-skilled employees often can more easily justify educational expenses as related to their current job while, for example, a clerk may have difficulty in justifying most educational expenses as directly related to his or her current job.

Others believe that the section 127 exclusion would favor higher-income individuals, in part because exclusions are more valuable to higher-income taxpayers. Also, the exclusion might be utilized to a greater extent by higher-income taxpayers. Nondiscrimination rules would help ensure that lower-income taxpayers also benefit, though not necessarily to the same extent.

The section 127 exclusion was viewed by some as a method to avoid considerable uncertainty for employers and employees regarding eligible job-related educational expenditures. Many believe that it is administratively difficult for taxpayers and the IRS to distinguish job-related from other educational expenses, and that the prior-law exclusion provided a useful simplification. Others believe that if the prior-law exclusion is not reinstated, the IRS could provide additional guidance defining job-related education.

D. Certain Student Loan Bonds

Exception to arbitrage rebate rules

Typically, student loan bonds are issued by qualified scholarship funding corporations or other issuers which have been specifically created to administer these programs. Generally, qualified scholarship funding corporations do not receive direct assistance from State governments. Recognizing this fact, Congress permitted these issuers to utilize arbitrage earned on their bond issues to finance their operations for a transitional period while they sought more permanent financing from the State government or other sources. Since arbitrage earnings on the issue of tax-exempt securities largely come at the expense of lost Federal revenue, this special exemption is equivalent to the Federal Government funding the operation of these independent corporations. S. 2149 would make permanent this implicit Federal funding of these independent corporations.

Some argue that Federal funding of these corporations is appropriate because they administer the operation of Federal education assistance programs (the GSL and PLUS education loans). Since the benefits derived from higher education do not accrue to any one State, but to the nation as a whole, Federal assistance to these corporations links program costs to program benefits. In addition, operating these loan programs through corporations at the State level decentralizes the administration of the programs and places it closer to those receiving the loans. This decentralization can create opportunities for experimentation at the State level and also may facilitate monitoring of the program. Permitting these corporations to finance themselves through arbitrage earnings removes their budgets from the political process and assures their continued smooth functioning.

Others argue that while the Federal Government provides interest subsidies for GSL and PLUS loans, these programs are State-administered programs which direct the loans to State residents. Since the immediate benefits are directed to State residents, the States should pay the administration costs. The purpose of these Federal programs is to utilize tax-exempt bonds to lower the borrowing costs of eligible students, not to provide an indirect subsidy to program operating expenses. Early issuance of tax-exempt bonds to maximize profits is inefficient. The cost of arbitrage to the Federal Government is greater than the revenue lost to an equal incremental issue of tax-exempt bonds used to lower student borrowing costs.

In addition, it is argued that financing the operation of these corporations by arbitrage earnings removes the administration of these programs from Federal or State budgetary oversight. Unlimited use of arbitrage earnings permits the corporations to determine their own administrative budget. Lastly, making permanent this transitional exception would establish for these private corporations more favorable arbitrage rules than those that apply to any other tax-exempt bond. For example, State and local governments are not permitted such treatment on their general obligation bonds.

Issuance of supplemental student loan bonds

States may issue supplemental student loan bonds as private activity bonds S. 2149 would permit private corporations to issue bonds which are presently the purview of the States. In addition, by extending the exception from arbitrage rebate rules to these corporations, the bill would implicitly fund the administration of State supplemental student loan program with foregone Federal revenues.

Some believe that consolidating these programs would lower overall administrative costs. In addition, exempting the State supplemental student loan bonds from arbitrage rules would further the Federal goal of providing low-cost funding for post-secondary education.

Opponents argue that while GSL and PLUS loans both carry explicit Federal subsidies and guarantees, the State supplemental student loan bonds do not. Moreover, the loans made from the proceeds of supplemental student loan bonds are not subject to the Federally mandated income targetting rules. Since the supplemental student loans are purely a State program, and do not necessarily fulfill Federal policy goals of aiding lower-income families, it may be inappropriate to finance the administration of the State program through the Federal revenue loss which arbitrage generates.

APPENDIX

Direct Aid to Students for Post-Secondary Education

Background

Throughout the 1980's, more than 12 million students have enrolled annually in post-secondary education or training programs, with approximately 80 percent enrolled in public institutions and 20 percent in private institutions. From the average high school graduating class, 65.8 percent enroll in some form of post-secondary education or training program at some point in the four years following their high school graduation. During this period, 45.2 percent attend a four-year college or university, 27.9 percent attend a two-year college, and 7.6 percent attend a vocational or technical training school.[1]

In every year since 1981, the costs of attending a two- or four-year college have risen faster than the rate of inflation; by contrast, in the late 1970's college costs lagged behind inflation. As Table 1 below details, since 1976 college tuition and fees generally have risen 30 percent more than the economy's overall price level. For the 1975–76 academic year, the total cost of attending a four-year private college averaged $4,391 (tuition of $2,240) and the total cost of attending a four-year public college averaged $2,679 (tuition of $578). For the 1986–87 academic year, the comparable total cost figure had risen to $10,199 (tuition of $5,793) for a four-year private college and to $5,604 (tuition of $1,337) for a four-year public college.

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[1] Center for Education Statistics. *The Condition of Education 1987.* The subcategories do not add to 65.8 percent because an individual may be counted in more than one category. For example, a student might attend a junior college before attending a four-year college.

Table 1.—Annual Percentage Change in Average College Costs, 1976–1987

Year [1]	2-year colleges				4-year colleges				Change in Consumer Price Index (CPI)
	Public		Private		Public		Private		
	Tuition and fees	Total cost of resident students	Tuition and fees	Total cost of resident students	Tuition and fees	Total cost of resident students	Tuition and fees	Total cost of resident students	
1977	28.6	1.8	5.3	5.9	7.4	4.1	4.0	4.0	6.5
1978	0.5	3.9	4.1	2.8	0.0	4.2	6.3	5.3	7.7
1979	4.9	4.5	6.5	6.2	4.8	5.1	6.9	6.2	11.3
1980	–4.7	3.5	5.9	6.7	4.5	6.7	10.4	8.1	13.5
1981	19.3	13.1	1.8	8.8	3.8	4.6	12.2	10.1	10.4
1982	1.1	3.4	26.6	22.0	16.0	13.6	13.1	13.2	6.1
1983	26.9	10.3	–5.5	2.6	19.5	13.3	8.4	8.6	3.2
1984	4.4	8.6	24.5	15.0	12.9	7.6	15.1	12.9	4.3
1985	–3.7	3.4	10.0	6.9	1.9	3.4	8.4	6.9	3.6
1986	10.2	[2] NA	9.3	8.9	10.3	8.9	8.0	7.1	1.9
1987	0.6	[2] NA	5.1	4.7	7.6	5.5	6.9	5.6	3.7
1976–1987	120.2	[2] NA	136.7	118.3	131.2	109.2	158.6	132.2	99.6

[1] Change is measured from preceding year. Hence, 1979 measures the change from 1978 to 1979.
[2] Not available.

Source: S. Boren, "Selected Tables and Readings Related to College Costs," Congressional Research Service, September 16, 1987.

Federal direct aid to post-secondary students

Pell Grants

Pell Grants provide a foundation of financial aid, to which aid from other Federal and non-Federal sources may be added. To qualify, the student must be an undergraduate enrolled at least half-time. In addition, the student or his or her parents must satisfy a needs test based on the student's or parents' current income and accumulated assets.

The maximum award for the 1987–88 academic year is $2,100; no repayment is required. Pell Grants are usually limited to providing assistance for five years of study. Pell Grants are awarded without regard to the school the student chooses to attend.

Supplemental Educational Opportunity Grants

A Supplemental Educational Opportunity Grant ("SEOG") is an award for undergraduates with exceptional financial need, with priority given to Pell Grant recipients. As a grant, it does not have to be repaid.

The maximum SEOG is $4,000 per year. The size of the grant a student receives depends upon need and the availability of SEOG funds at the school. Financial need is determined by reference to the Uniform Methodology.[2] The Uniform Methodology makes a different calculation of need than does the Pell Grant, but like the Pell Grant bases its calculation on the student's or his or her parents' current income and accumulated assets.

College Work-Study

The College Work-Study ("CWS") Program provides wage subsidies to colleges for jobs held by undergraduate and graduate students who need financial aid. The student must be paid at least the Federal minimum wage, but may be paid more depending upon the type of work. A student's award of CWS funds depends upon need as determined by the Uniform Methodology, the availability of funds at the school, and other sources of aid.

Perkins Loans

Perkins Loans, formerly National Direct Student Loans, are low-interest loans (currently five percent) to students for post-secondary undergraduate or graduate education. Eligibility is needs-tested based on the Uniform Methodology.

The student may borrow up to $4,500 if enrolled in a vocational program or if he or she has completed less than two years of a program leading to a bachelor's degree; up to $18,000 if the student has completed two years of study toward a bachelor's degree; and up to $18,000 for graduate or professional study. This latter total includes any Perkins Loans received to finance undergraduate studies.

No payment of principal or interest is required until nine months after the student graduates or leaves school. Interest payments may be deferred thereafter under certain circumstances, such as service in the Armed Forces. The borrower has up to 10 years to repay.

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[2] *See*, S. Boren, "Provisions of the Pell Grant Family Contribution Schedule and the Uniform Methodology As Contained in the Higher Education Amendments of 1986," Congressional Research Service, July 9, 1987.

Guaranteed Student Loans

A Guaranteed Student Loan ("GSL") is a low-interest loan made to the student by a private lender such as a bank; these loans are insured by a State guarantee agency and reinsured by the Federal Government. The interest rate for GSLs commencing July 1, 1988 will be eight percent. The Federal Government pays a special allowance to lenders to bring the GSL borrower's rate up to approximately the fair market rate. Eligibility is determined by the Uniform Methodology. The GSL program is a needs-tested entitlement program, the only entitlements program in the Department of Education.

Depending upon need, the student may borrow up to $2,625 per year if a first- or second-year undergraduate student; up to $4,000 if two years of undergraduate study have been completed; and up to $7,500 per year if a graduate student. As an undergraduate, the total amount of GSL debt the student may have outstanding is $17,250. The total for graduate study is $54,750, including loans received as an undergraduate.

Loan repayments begin six months after the completion of study. Loan payments may be deferred under certain circumstances. The Federal Government makes interest payments on behalf of the student while the student is enrolled in school and during deferral periods. The lender must permit at least five years and may allow up to 10 years to repay.

PLUS Loans and Supplemental Loans for Students

PLUS loans are for parent borrowers and Supplemental Loans for Students ("SLS") are for independent student borrowers. Like GSLs, they are made by private lenders to the parents or the student. SLS and PLUS loans carry a variable interest rate, adjusted annually. The variable rate is based on the bond equivalent rate of the 52 week Treasury-bill plus 3.25 pecentage points. For the 1987–88 academic year, the interest rate is 10.27 percent. PLUS and SLS loans are not needs-based.

The loans are insured by the State guarantee agency and reinsured by the Federal Government. Unlike GSL loans, the Federal Government does not pay interest during deferral periods. The only direct Federal subsidy, aside from insuring defaults, occurs if the calculated interest rate for PLUS and SLS loans rises above 12 percent. In that circumstance, the loan rate is capped at 12 percent and the Federal Government pays a special allowance to lenders.

PLUS enables parents to borrow no more than $4,000 per year, up to a total of $20,000, for each child who is enrolled at least half-time. Under SLS, graduate students and independent undergraduates may borrow no more than $4,000 per year, up to a total of $20,000. This amount is in addition to the GSL limits.

State Student Incentive Grants

State Student Incentive Grants provide grants to those States which establish a scholarship program and use State funds to match the Federal funds. The maximum grant a student may receive under this program is $2,500. The States establish the eligibility criteria.

Scope of direct aid to students

In addition to Federal aid, direct aid is available to post-secondary students from State programs and from private institutions. Table 2, below, shows the trend in direct aid to students since 1970. Since 1975, total aid available and institutional aid have risen roughly at the rate of overall inflation, but somewhat less than the more rapidly rising college costs. Because total enrollment in institutions of higher education has risen from 11.2 million to 12.2 million, student aid per enrolled student has not kept up with the overall inflation rate.[3]

Table 2.—Sources of Student Aid to Higher Education, Selected School Years 1970–71 to 1985–86

[In million of dollars]

Source	1970–71	1975–76	1980–81	1985–86
Federal student aid:				
Pell grants		936	2,387	3,749
SEOG grants	134	201	366	396
College work study	227	295	658	693
Perkins loans	240	460	695	841
Guaranteed student loans, PLUS, and SLS	1,015	1,267	6,201	9,411
State student incentive grants		20	76	76
Subtotal	1,616	3,179	10,383	15,166
Other Federal aid:				
Veterans	1,121	4,180	1,714	746
Social Security	499	1,093	1,883	0
Other aid	109	180	190	[1] NA
Institutionally awarded aid	965	1,435	2,138	3,426
State grant programs	236	490	801	1,374
Total	**4,495**	**10,486**	**17,099**	**21,008**

[1] Not available.

Source: S. Boren, "Selected Tables and Readings Related to College Costs," Congressional Research Service, September 16, 1987.

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[3] S. Boren, "Selected Tables and Readings Related to College Cost," Congressional Research Service, September 16, 1987.

Table 2 indicates that loans are the fastest growing component of Federal aid. However, the growth of total borrowing does not necessarily imply that real indebtedness of students has increased.

Table 3 shows that while the number of students receiving Federally sponsored loans has increased substantially, the average GSL and Perkins loans, measured in constant dollars, has decreased slightly. More students are using Federally sponsored loans rather than each student taking a larger loan. On a per-student basis, this suggests that nonloan direct aid to students has declined even more.

Table 3.—Post-Secondary Student Borrowing by Program, Selected School Years 1970-71 to 1985-86

[Number of loans in thousands]

Program	1970-71	1975-76	1980-81	1985-86
Guaranteed Student Loans				
Number of loans	1,017	922	2,899	3,640
Average loan:				
Current dollars	$998	$1,374	$2,134	$2,277
Constant 1986 dollars	$2,824	$2,784	$2,770	$2,333
Perkins Loans				
Number of loans	452	690	813	854
Average loan:				
Current dollars	$532	$667	$853	$880
Constant 1986 dollars	$1,505	$1,351	$1,107	$902
PLUS Loans				
Number of loans	[1] NA	[1] NA	6	212
Average loan:				
Current dollars	[1] NA	[1] NA	$2,333	$2,585
Constant 1986 dollars	[1] NA	[1] NA	$3,029	$2,649

[1] Not applicable.

Source: J. Hansen, "Student Loans: Are They Overburdening A Generation?" College Entrance Examination Board, February 1987.

Table 4 indicates that student debt, from all sources, has risen as a percentage of college costs. In conjunction with Table 3 data, this might suggest that non-Federally sponsored borrowing has increased in importance.

Table 4.—Comparison of Cumulative Debts of 1977 and 1984 College Graduates

	1977 Graduates		1984 Graduates	
	Public	Private	Public	Private
Average cumulative debts	$2,348	$3,114	$4,970	$6,350
Average cost of 4 years of college	$10,500	$17,900	$17,100	$32,500
Debts as percentage of costs..	22	17	29	20

Notes: Based on Department of Education surveys of college graduates. Cumulative debt is defined as total educational debt from all sources. Data only includes full-time employed graduates of four-year institutions who incurred some positive amount of educational debt.

Source: C. Henderson, "College Debts of Recent Graduates," American Council on Education, December 1987.

Tax expenditures for education

Present law contains several provisions which directly benefit education and training. For example, scholarship and fellowship income is excluded from taxation (up to certain limitations). Parents may claim an exemption for students age 19 or over. The interest on State and local government student loan bonds is tax-exempt. Contributions to educational institutions are tax-deductible for itemizers, subject to certain limitations. Over the next five years, fiscal years 1989-1993, the various tax expenditures related to education and training are estimated to be worth $17.2 billion.[4]

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[4] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 1989-1993* (JCS-3-88), March 8, 1988.

TESTIMONY BY SENATOR ROBERT T. STAFFORD BEFORE THE FINANCE COMMITTEE ON THE CONSIDERATION OF TAX INCENTIVES FOR EDUCATION SAVINGS PLANS

MARCH 15, 1988

MR. CHAIRMAN, LET ME BEGIN BY COMMENDING THE COMMITTEE FOR CONVENING TODAY'S HEARING ON EDUCATION SAVINGS PLANS. AS THE RANKING MINORITY MEMBER ON THE SUBCOMMITTEE ON EDUCATION, I HAVE COSPONSORED TWO BILLS WHICH WOULD ENCOURAGE FAMILIES TO INVEST IN EDUCATION THROUGH THE PURCHASE OF TUITION SAVINGS BONDS. IT IS MY FIRM BELIEF THAT THE ENACTMENT OF SUCH LEGISLATION WOULD PROVIDE A VITAL EXPANSION OF EXISTING FEDERAL STUDENT FINANCIAL AID PROGRAMS. THE PROPOSALS BEFORE YOU TODAY ENCOURAGE A PRINCIPAL WHICH HAS BEEN LOST IN OUR CURRENT FEDERAL SYSTEM OF SUPPORT FOR HIGHER EDUCATION - THAT PRINCIPAL IS SAVING FOR YOUR CHILDREN'S EDUCATION.

THE COST OF A POSTSECONDARY EDUCATION IS SKYROCKETING. CONSEQUENTLY, THE OPPORTUNITY TO PURSUE EDUCATION BEYOND HIGH SCHOOL IS MOVING OUT OF REACH FOR MANY OF OUR NATION'S YOUTH. AT A TIME WHEN THE IMPORTANCE OF IMPROVED TECHNOLOGICAL TRAINING TO KEEP AMERICA COMPETITIVE IS IN THE FOREFRONT OF THE PUBLIC CONSCIOUSNESS, IT IS IMPERATIVE THAT OPPORTUNITIES FOR POSTSECONDARY EDUCATION EXPAND, NOT DIMINISH.

FOR THE SEVENTH STRAIGHT YEAR, TUITION HAS RISEN FASTER THAN INFLATION. THE PROJECTED TUITION FOR A PRIVATE SCHOOL IN THE YEAR 2005 IS $88,778. IN 1979, THE AVERAGE COST OF ATTENDING 4 YEARS AT MIDDLEBURY COLLEGE, MY OWN ALMA MATER, WAS $34,900. I WON'T TELL YOU THE COST WHEN I WAS THERE. THE CURRENT ESTIMATE FOR 4 YEARS -- THAT'S ONLY TUITION, ROOM AND BOARD -- IS $67,807. THAT'S AN INCREASE OF ALMOST 50% IN LESS THAN 10 YEARS. ONLY THE MOST AFFLUENT AMERICAN FAMILIES CAN AFFORD SUCH AN INVESTMENT WITHOUT ASSISTANCE. WHILE INCREASED FEDERAL COMMITMENT VIA INCREASED FUNDING FOR PELL GRANTS AND GUARANTEED STUDENT LOANS IS

PART OF THE SOLUTION, NEW INITIATIVES WHICH ENCOURAGE SAVINGS MUST BE ENACTED.

ONLY A DECADE AGO, GRANTS MADE UP 75% OF A STUDENT AID PACKAGE; LOANS COMPRISED THE OTHER 25%. NOW, 10 YEARS LATER, LOANS MAKE UP 2/3's OF THE FINANCIAL AID PACKAGE FOR A STUDENT. WE ARE COMING PERILOUSLY CLOSE TO A TIME WHEN ONLY THE WEALTHY WILL BE ABLE TO ATTEND COLLEGE AT THE INSTITITION OF THEIR CHOICE.

IN 1965, CONGRESS ESTABLISHED THE GUARANTEED STUDENT LOAN PROGRAM. THIS WAS DESIGNED AS A LOAN OF CONVENIENCE FOR MIDDLE INCOME FAMILIES. SINCE ITS INCEPTION OVER 20 YEARS AGO, THE GSL HAS REPLACED THE PELL GRANT AS THE PRINCIPAL FORM OF AID FOR LOWER INCOME STUDENTS. TODAY'S GSL BORROWER OFTEN HAS AN INCOME EQUAL TO THE RECIPIENTS OF MAXIMUM PELL GRANT ASSISTANCE. THE CONSEQUENCES OF THESE CHANGES IN GSL ELIGIBILITY ARE EVIDENCED BY THE CURRENT DEFAULT CRISIS IN THE PROGRAM.

OVER $65 BILLION HAS BEEN LOANED TO STUDENTS THROUGH THE GSL PROGRAM. THE PROJECTED ANNUAL BORROWING RATE IS $9 BILLION. IN THE PAST SEVEN YEARS ALONE STUDENT INDEBTEDNESS HAS INCREASED BY 60%. THAT MEANS THAT CLOSE TO FIFTY PERCENT OF ALL GRADUATES BEGIN JOB HUNTING ALREADY $7000 IN DEBT. THAT ESTIMATE JUMPS TO $9000 FOR GRADUATES OF PRIVATE INSTITUTIONS. CERTAINLY COLLEGE GRADUATES ENTER THE WORK FORCE AT A DISTINCT ADVANTAGE IN TERMS OF FUTURE EARNING POWER. WE MUST BE CAREFUL, HOWEVER, NOT TO LIMIT CAREER CHOICES BY FORCING STUDENTS TO CONSIDER ONLY THOSE POSITIONS WHICH OFFER THE HIGHEST SALARIES.

THE PROPOSALS BEFORE YOU ARE ALL RELATIVELY SIMPLE TO UNDERSTAND AND TO ENACT. FOR EXAMPLE, S. 1817, THE EDUCATION SAVINGS BOND ACT, WOULD PERMIT TAXPAYERS TO TRANSFER U.S. SAVINGS BONDS TO AN INSTITUTION OF HIGHER EDUCATION OR VOCATIONAL SCHOOL AS PAYMENT FOR TUITION AND SCHOOL COSTS. IF THE BOND IS USED IN THIS FASHION, THE INTEREST ON THE BOND WOULD BE EXCLUDED FROM THE TAXPAYER'S GROSS INCOME. SHOULD AN INDIVIDUAL DECIDE NOT TO USE THEIR BOND FOR HIGHER EDUCATION PURPOSES, THERE WOULD BE NO LOSS

OF MONEY. INSTEAD, THE INDIVIDUAL FORFEITS ONLY THE TAX EXEMPTION THAT IS PROVIDED WITH THIS BILL.

THE INTEREST DEDUCTION IS APPROPRIATELY FASHIONED TO PROVIDE THE MOST BENEFIT TO FAMILIES WHICH NEED THE MOST ASSISTANCE. STARTING AT AN ADJUSTED GROSS INCOME OF $75,000, ONLY 67% OF THE INTEREST EARNED IS EXCLUDABLE. AT $125,000, THE EXCLUDABLE INTEREST DROPS TO 34% AND FINALLY AT $150,000, THE TAX BENEFIT IS LOST. I MIGHT ADD THAT THE BILL PROVIDES FOR THESE BRACKETS TO BE INDEXED ACCORDING TO THE CONSUMER PRICE INDEX EACH YEAR.

THERE ARE SEVERAL OTHER STRONG POINTS RELEVANT TO SEVERAL OF THESE BILLS WHICH I FEEL ARE WORTH NOTING. FIRST AND FOREMOST IS THE SIMPLICITY WHICH I HIGHLIGHTED EARLIER. NO COMPLICATED "NEEDS TEST" WOULD BE REQUIRED. ANYONE CAN PURCHASE A SAVINGS BOND EITHER INDIVIDUALLY OR, IN MANY INSTANCES, THROUGH AUTOMATIC PAYROLL DEDUCTIONS. CURRENTLY, OVER 46,000 COMPANIES OFFER SAVINGS BONDS THROUGH PAYROLL DEDUCTION PLANS WITH ABOUT 6.5 MILLION EMPLOYEES TAKING ADVANTAGE OF THIS PROGRAM.

THIS LEADS ME TO A SECOND POINT: ENCOURAGING THE PURCHASE OF U.S. SAVINGS BONDS. IN FY 1987, $10.3 BILLION WORTH OF SAVINGS BONDS WERE SOLD TO AN ESTIMATED 9 MILLION AMERICAN FAMILIES. INCREASING THE NUMBER OF SAVINGS BONDS SOLD EACH YEAR HAS ADDED BENEFITS FOR THE FEDERAL TREASURY WHICH WE ALL CAN SUPPORT. REDUCING TAX REVENUES THROUGH ENACTMENT OF SAVINGS BOND LEGISLATION MUST CERTAINLY BE AN IMPORTANT CONSIDERATION FOR THE COMMITTEE. HOWEVER, THESE COST FACTORS SHOULD BE WEIGHED AGAINST BENEFITS WHICH INCLUDE A BETTER EDUCATED WORK FORCE AND REDUCED INDEBTEDNESS.

THIS PROPOSAL ALSO ENCOURAGES SAVING FOR THE FUTURE. I GREW UP IN AN ERA IN WHICH SAVING FOR THE FUTURE WAS EMPHASIZED, WHETHER FOR A HOUSE OR A COLLEGE EDUCATION. IN THE MIND OF THIS SENATOR, THAT IS A VALUE WHICH OUR FEDERAL FINANCIAL AID PROGRAMS SHOULD

PROMOTE, NOT DISCOURAGE. TO BURDEN THE NEXT GENERATION WITH INORDINATE DEBT IS SHORTSIGHTED AND POTENTIALLY DEVASTATING TO OUR ECONOMIC FUTURE.

FINALLY, A FEDERALLY ENACTED TUITION SAVINGS PLAN HAS THE ADDED BENEFIT OF PORTABILITY. A FEDERAL COMMITMENT TO SUCH A PLAN WILL ASSURE A STUDENT THE RIGHT TO ATTEND AN INSTITUTION OF CHOICE, REGARDLESS OF LOCATION. MANY STATE SAVINGS PLANS WHICH HAVE BEEN ENACTED OR ARE UNDER CONSIDERATION LIMIT STUDENT OPTIONS. A STUDENT FROM MASSACHUSETTS WHO WISHES TO ATTEND ONE OF VERMONT'S FINE INSTITUTIONS, SHOULD HAVE THAT OPPORTUNITY.

A RECENT STUDY FOUND THAT 3 OUT OF 4 PARENTS WHO WANTED THEIR CHILDREN TO ATTEND A PRIVATE INSTITUTION SAID THEY EXPECTED THEM TO ATTEND A PUBLIC UNIVERSITY BECAUSE THEY "DIDN'T BELIEVE THEY WOULD BE ABLE TO AFFORD IT". HISTORICALLY, OUR FEDERAL STUDENT AID PROGRAMS HAVE GUARANTEED BOTH ACCESS AND CHOICE IN HIGHER EDUCATION. THESE [illegible] PRINCIPALS WHICH WE MUST STRIVE TO PRESERVE IF WE WANT OUR [illegible] TO RETAIN THEIR INTERNATIONAL PREEMINENCE.

I WOULD LIKE TO LEAVE [illegible] WITH THESE THOUGHTS. A RECENT SURVEY FOUND THAT 74% OF THE GENERAL PUBLIC FAVORED FEDERAL TAX INCENTIVES FOR THOSE WHO SAVE FOR COLLEGE. IN MY OWN STATE OF VERMONT, THE HIGHER EDUCATION COUNCIL PASSED A RESOLUTION ENDORSING A SAVINGS BOND PROPOSAL ENACTED AT THE FEDERAL LEVEL. CLEARLY, THERE IS NATIONAL SUPPORT FOR TUITION SAVINGS LEGISLATION. I AM HOPEFUL THAT YOUR COMMITTEE WILL ACT SWIFTLY TO BRING A BILL BEFORE THE FULL SENATE FOR THEIR CONSIDERATION. TODAY'S HEARING MARKS AN IMPORTANT STEP TOWARD THIS GOAL. I APPRECIATE HAVING THE OPPORTUNITY TO APPEAR BEFORE YOU. THANK YOU.

STATEMENT OF SEN. CLAIBORNE PELL (D,RI), CHAIRMAN OF THE SUBCOMMITTEE ON EDUCATION, ARTS AND HUMANITIES AT HEARING ON TAX INCENTIVES FOR EDUCATION BEFORE THE COMMITTEE ON FINANCE

Mr. Chairman, I want to commend you for holding this important hearing.

As you know, Senators Stafford, Kennedy and I have introduced two of the seven measures on tuition savings plans before you today. One of these is the NEST proposal, which would establish a national education savings trust fund. For the poorest families, contributions to the fund would be tax exempt, while for others contributions would have varying rates of tax deductibility. The other is the educational savings bond proposal, which would allow the earned interest on U.S. savings bonds to be tax exempt if the bonds were used to finance a child's education.

I would like to speak briefly this morning not on the details of the two proposals, but rather on the need for a new program to help families plan for and finance a college education.

Let me be clear from the outset, however, that I am not advocating either proposal as a replacement for our current federal student aid programs. Instead, I view any new plan as a supplement to our existing efforts.

The need for an additional program is without question. In the next decade, it is estimated that the cost of a college education will continue to skyrocket.

Unfortunately, it is unlikely that increases in our federal student aid programs will keep pace. That is certainly the case with past experience. While college costs have risen 77% since 1980, the value of federal student aid has decreased. For example, in 1980 a maximum Pell Grant award of $1750 could cover

41% of the average tuition bill. Today a maximum Pell Grant covers only 29% of such cost.

But this does not tell the whole story. Over the past decade we have moved from a situation in which the typical student aid package was three-fourths grants, and one-fourth loans to one which is precisely the opposite-- one-quarter grants and three-quarters loans. Several factors have combined to bring this about. The Administration's opposition to student aid increases for most of the past seven years is certainly a major factor, as is the budget deficit. The two have worked hand-in-hand to limit severely the aid increases students have needed.

Even worse, the failure of our grant programs to keep pace with increased college costs has forced the poorest students to borrow the most.

The sad fact is that we are creating an indentured class of young people saddled with enormous debts as they start out on a professional career. Loans accounted for 17 percent of student aid in 1975-76 and 49 percent in 1986-87.

This trend cannot continue. If it does, we will be pricing a college education beyond the reach of most students, even with federal grant or work study assistance. We need to make sure that the federal programs we have keep pace not only with inflation but also with the cost of a college education.

Sadly, this will not be enough. We cannot rely upon the federal programs we have to meet the total educational needs of our citizens. We must have a supplemental approach that will encourage families even of modest means to save at least some money for the college education of their children. And that, Mr. Chairman, is the rationale for the proprosals that are before you today.

I cannot end my testimony, however, without impressing upon you the urgency of the situation. If we do not put a new mechanism in place soon, we will face a very serious crisis.

Already the facts are very disturbing. The number of blacks pursuing a college education has declined from 34 percent to 26 percent in the past decade. The number of Hispanics has dropped from 36 percent to 27 percent over the same period. And, as I have noted earlier, even when students can find a way to go to college, they do so through enormous and unreasonable borrowing.

I am aware that any proposal of the kind before you will have a large price tag in terms of lost revenue. That cost will pale, however, if we consider the long-term cost to our Nation of not pursuing such a program. In a year in which there is much discussion of the need for the United States to make its work force more competitive, we would be short-sighted, indeed, if we failed to link such a concern with the availablility of education programs to future generations.

Again, I commend you for this hearing, and am grateful for having had the opportunity to share some of my thoughts with you.

Thank you.

STATEMENT OF SENATOR EDWARD M. KENNEDY AT THE SENATE FINANCE COMMITTEE HEARING ON TAX INCENTIVES FOR EDUCATION

Mr. Chairman and members of the Finance Committee, it is an honor to be here to discuss S.1817, the Education Savings Act.

For most Americans, a college education is an important part of the American dream. But a recent survey found that 82 percent of the public believe that rising costs will soon put a college degree out of reach for most families.

Between 1980 and 1986, college tuition increased by 75 percent, while family income grew by 33 percent. Tuition at America's best colleges can easily cost $12,000 a year. For children born in 1987, the annual bill may be over $30,000 by the time they are ready for college. And that is just for tuition: room, board, books and supplies will add much more to the price. For all but the very wealthy, that is not a dream. It is a nightmare.

We cannot allow rising costs to put a college degree out of reach. Widespread access to higher education is the nation's best hope for economic growth and social progress. Families must be able to afford the best possible education for their children.

One of the most effective ways to do this is to encourage families to save for future college expenses. But for many families, saving money is a difficult proposition.

I am proposing, therefore, to create an incentive to save for education through the purchase of U.S. Savings Bonds. We have used the tax code in the past to help bring the American dream to countless families. Through tax incentives, we have helped them buy their homes, meet their medical bills, and save for retirement.

But we have never helped them save for education. In fact, whether families put money away for a luxury cruise, a fur coat, a new car or a college education, they are taxed on their savings. That policy is out of touch with America's real priorities.

My proposal emphasizes the importance of saving for higher education. It is a simple, sensible way to help families save for college. It will give children security in their future, and a goal to strive for. It will not create a new government bureaucracy.

The plan works like this: if a family buys a U.S. Savings Bond and uses it to pay for their child's higher education, the interest earned on that bond will be permanently tax free. Bonds will be turned over to an eligible higher education institution as payment for tuition.

At the present time, interest on savings bonds is taxed, but the tax is deferred until the bond is redeemed. This plan would eliminate the tax completely, and give families an incentive to save for college expenses by investing in America. To ensure that those who most need help will be the ones who benefit, the tax exemption will be reduced beginning at an income of $75,000 and will be completely phased out at $150,000.

Savings bonds are an ideal investment for this purpose. First -- and most important in these uncertain times -- they are a safe investment, backed by the full faith and credit of the U.S. Government. There is no risk that the savings will be lost.

Our proposal does not require complex rules for changing circumstances. If a child does not attend college, the bond is still fully redeemable and the proceeds can be used for any purpose. All that is lost is the tax exemption.

Savings bonds are a familiar and popular way to save, which gives this plan an advantage over proposals to create a separate savings instrument for education. According to recent surveys, lower and middle income families, those with children under 18, and minorities prefer savings bonds to stocks, mutual funds, and other instruments of savings.

Savings bonds are also a convenient way to save. About 50,000 companies encourage employees to purchase them through payroll deductions -- an effective method to put money away for the future. Approximately 75 percent of savings bonds are now bought through payroll deductions. Bonds are also readily available at banks and other financial institutions, and can even be bought through the mail. Parents would have easy access to the program -- with no application to fill out or difficult choices to make.

The plan will also bring additional funds to the Treasury. If the sale of savings bonds grows by 10 percent, for example, it will generate $1 billion in additional funds.

The Joint Tax Committee estimates that the proposal will cost $300 million a year five years after enactment. Obviously, the estimate depends on assumptions as to how many families are likely to take advantage of the proposal. But even if it is accurate, it means that we will sell billions of dollars a year in savings bonds.

The net cost of the proposal to the Treasury will be offset by lower borrowing costs. According to the Treasury Department, the Government saves $60 million for every billion dollars sold in savings bonds. If our proposal results in the sale of $5 billion of savings bonds a year, the plan will be self-financing.

Some economists dispute the idea that tax incentives encourage new saving. Instead, they argue, the incentives only encourage taxpayers to shift from one form of saving to another. But U.S. Savings Bonds are different from other savings instruments, and there is an excellent chance that many families who are not saving now will do so, using this safe, convenient plan. In any event, I believe this tax incentive for Savings Bonds is justified, because it gives a higher priority to saving for education.

Finally, the proposal offers advantages over other current proposals for college saving. Some states are offering programs of their own, but they can only be used within the state. The creation of a new form of savings bond for education has also been suggested, but I see no need for such duplication and complexity, when regular U.S. Savings Bonds can do the same job better.

The federal commitment to college aid is well-established. The Reagan Administration's efforts to cut back student assistance programs have failed; if anything, those efforts have solidified a new consensus about education as a national priority and the need for a strong federal role. Student aid programs deserve to be increased, not placed on the chopping block.

The federal role is, and must remain, focused on financial resources for economically disadvantaged students. But rising costs threaten to put a college degree out of reach of average families too, and we must find a safe, convenient and simple way to help them meet tuition bills.

We have long known the value of investing in education -- and the cost of not doing so. Today we link two long-standing American institutions -- the U.S. education system and U.S. Savings Bonds. Each will benefit the other, and make America stronger in the future.

STATEMENT OF SENATOR PAUL SIMON (D.,IL)
ON S. 1817, EDUCATION SAVINGS ACT

March 15, 1988

Mr. Chairman, I am pleased to join you today and my colleagues on the Labor and Human Resources Committee in support of S. 1817, the Education Savings Act of 1987. This bill introduced on October 23, 1987 by Senators Kennedy and Pell represents the most serious federal option, yet proposed, to assist middle and upper income families save for college expenses. Cash-flow is one of the most serious problems facing American families -- who are frequently unprepared to pay the rising cost of a college education. This issue -- paying for college -- is one of the most frequently raised questions among my Illinois constituents and parents around the country.

We are rapidly reaching a point in time when middle income families will not be able to afford to send their children to the college of their choice. Since 1980, private, four-year colleges have increased their total costs from an average of $5,888 annually to an average of $11,210 in 1986, while total costs at public, four-year institutions have risen from an average of $2,487 to $4,156 -- with an average 8-10% increase each academic year since 1986. Another 6% increase in these costs is forecast for the 1988-89 academic year.

The cost of a college education has risen twice the rate of inflation during the 1980's, prompting Education Secretary Bennett to launch an all-out attack on higher education. Much of Bennett's attack is unwarranted. This is largely because his allegation that colleges raise tuition to "capture" increases in federal student aid is not supported by the facts -- there has been <u>no</u> increases in the Guaranteed Student Loan (GSL) maximum during the 1980-86 period and only one increase in the Pell Grant maximum award -- and he ignores the fact that institutional financial aid has increased (40 percent) to accommodate the failure of federal student aid programs to grow. As costs have spiraled, so has the reliance of students of all income levels on loans.

The `borrow now, learn later' philosophy has increased student indebtedness to an average of $10-$15,000. Dramatic shifts from grant aid to loan aid for lower income students -- only 16.9 percent of first-time, full-time freshman received pell grants in the Fall of 1986, compared to 31.5 percent in 1980, a decline of 267,000 pell recipients -- have exacerbated the rising cost trend, forcing more students, at all income levels, into more and more debt. Many also choose lower cost postsecondary options such as community colleges.

The two most disturbing trends: (1) the shift of federal assistance from 80% grant aid and 20% loan aid in 1975-76 to 46% grant aid and 51% loan aid (4% work study) in 1986-87; and (2) the shifting of the parental responsibility to pay for college to their sons and daughters is reflected in rising student loan defaults and rising levels of student indebtedness. It is crucial to understand that default rates have not risen, the volume against which the default is measured has quadrupled in the last decade!

The solution to the problem is simple -- increase the amount of grant aid to lower income students and encourage those families who can to save for the cost of a college education. This must be done in a way which does not reduce revenues to the Federal

Government, nor prevent the Congress from providing critically needed increases in grant and work-study funds for low and middle income students, especially those attending independent institutions.

S. 1817 addresses both of those concerns -- it does not create a substantial drain on the federal treasury as do many of the education savings account proposals, nor does it penalize those who cannot afford to save and must depend on Pell Grants and the campus-based programs, especially College Work Study and Supplemental Educational Opportunity Grants.

I hope the Committee will look favorably on S. 1817 and take steps to move this legislation as soon as possible. Those of us who serve on the Labor and Human Resources Committee will take the next step -- modify the Congressional Methodology or needs analysis, which evaluates parental income and assets so that htose who save are not penalized for doing so.

Paul Simon

STATEMENT OF SENATOR CHARLES GRASSLEY
BEFORE THE SENATE FINANCE COMMITTEE
TUESDAY, MARCH 15TH, 10:00 A.M.

Mr. Chairman, thank you for this opportunity to testify before your committee. I want to commend you and the other committee members for conducting this hearing on education tax incentives. I believe that tax incentives for education must be an essential part of our nation's education policy.

I am appearing before your committee to urge support of legislation which I have introduced. My bill would correct a grave mistake that was made in the 1986 Tax Reform Act.

In the 1986 Act, Congress phases out income tax deductions for personal interest. This repeal does not make any allowance for educational interest expense. Educational investment is treated no differently than loans for consumer goods.

I am also concerned about the effect of this repeal on student loan defaults. The default problem is already too big. American taxpayers will have to pay more than $1.6 billion this year to cover defaulted student loans.

This repeal will further erode the abilities of thousands of recent graduates in meeting loan repayment commitments. In effect, it changes the rules in the middle of the game. Recent college graduates took out loans thinking they could deduct the interest from their taxable income. Now, it will be even more difficult for students to make loan payments by eliminating the benefit of tax deductions for the interest expense.

I visit with many college students here in Washington, D.C., as well as back in Iowa. Many of these students tell me they are "afraid of going into debt" in order to finance their college education. Their fears will be heightened by the inability to deduct interest costs.

Mr. Chairman, I think loans are a legitimate way for the federal government to provide financial assistance to college students. Those students who would benefit most from higher education, however, will be reluctant to go to school unless they can acquire outright grants. We all know that such grants are available to relatively few students.

Repealing the deductibility for student loan interest also makes it more diffifult for parents to contribute to their children's education. The costs for financing education are increased and parents will have less disposable income to invest in education.

I urge the Committee to study the full implications of even higher default rates in the Guaranteed Student Loan Program.

I have introduced legislation to correct the mistakes of the last Congress. My bill, S.628, would restore tax deductibility for students' interest expenses on their student loans. The deductibility could be applied to education costs. Allowed costs would include tuition, fees, books, supplies, and equipment. It could also be applied to reasonable living expenses while away from home for primary, secondary, college, and graduate level education.

Many of the proposals presented to the Finance Committee today entail tax exemptions for income from savings bonds used to finance higher education. I endorse this concept and am a co-sponsor of Senator Kennedy's bill, S.1817.

Even more than these proposals, however, I urge the Finance Committee to *first* correct the mistakes of the previous Congress. I urge the Committee to correct tax disincentives for existing education programs. I believe that my proposal, S.628, will make these corrections. Restoring the tax deductibility for interest on student loans will enhance the Guaranteed Student Loan Program.

The Finance Committee has a very special opportunity to *directly* help college graduates. Only the Finance Committee, by approving legislation to put money back in the pockets of successful students, can *directly* provide education incentives to America's youth. Education "programs" themselves obviously are essential to students. But to provide education incentives to the *individual*, the most *effective* incentive goes directly to the student - such as a tax deduction.

Mr. Chairman, by taking the action to repeal tax deductibility, Congress has actually imposed a new tax on individuals seeking to better themselves through education. In effect, Congress has imposed a tax on human potential.

Education is an national investment which will be an important factor in determining the future of America.

A WELL-EDUCATED WORK FORCE IS VITALLY IMPORTANT IF WE ARE TO COMPETE EFFECTIVELY IN AN INTERNATIONAL ECONOMY. RESTORING THE TAX DEDUCTION FOR INTEREST ON STUDENT LOANS WOULD EMPHASIZE THE VALUE WE PLACE ON EDUCATION.

TO SUMMARIZE, I BELIEVE THE DEDUCTIBILITY ON INTEREST ON STUDENT LOANS SHOULD BE RETAINED FOR THREE MAIN REASONS.

FIRST, THE INTEREST ON LOANS SECURED BY PRIMARY AND SECONDARY RESIDENCES, AND SUBSEQUENTLY USED FOR EDUCATIONAL PURPOSES, REMAINS DEDUCTIBLE. THIS HAS THE EFFECT OF PENALIZING LOW INCOME TAXPAYERS WHO DO NOT OWN HOMES, BUT DO HAVE DREAMS OF EDUCATING THEIR CHILDREN OR THEMSELVES.

SECOND, BY LUMPING EDUCATION EXPENSES WITH CONSUMER EXPENSES, CONGRESS FAILED TO MAKE AN IMPORTANT DISTINCTION. THE ABILITY TO DEDUCT INTEREST ON CONSUMER LOANS SUPPOSEDLY DISCOURAGED CONSUMER SAVING. UNDER THE '86 ACT, TAXPAYERS WILL BE MORE INCLINED TO SAVE FOR DISCRETIONARY PURCHASES, RATHER THAN TO BUY ITEMS ON CREDIT. EDUCATION LOANS, HOWEVER, ARE NOT DISCRETIONARY. THEY ARE A NECESSITY. ONLY VERY PRIVILEGED PERSONS CAN FINANCE HIGHER EDUCATION WITHOUT RELYING HEAVILY ON STUDENT LOANS.

THIRD, AID TO HIGHER EDUCATION HAS BEEN REDUCED. AS THE AMOUNT OF FINANCIAL ASSISTANCE FOR HIGHER EDUCATION DECREASES, IT IS ESPECIALLY IMPORTANT THAT CONGRESS REDUCE STUDENTS' COSTS FOR THE ASSISTANCE THAT IS AVAILABLE. REINSTATING THE DEDUCTIBILITY OF INTEREST ON LOANS FOR EDUCATIONAL EXPENSES WILL HELP EASE THE BURDEN OF REPAYING COLLEGE EXPENSES.

BEFORE I CONCLUDE, I WOULD LIKE TO MENTION THAT SIMILAR MEASURES HAVE BEEN INTRODUCED IN THE OTHER BODY. H.R. 592, BY CONGRESSMAN SCHULZE AND CONGRESSMAN TAUKE IS IDENTICAL TO MY BILL, S.628. I BELIEVE CONGRESSMAN SCHULZE IS SUBMITTING WRITTEN TESTIMONY ON BEHALF OF THE LEGISLATION.

THANK YOU FOR THE OPPORTUNITY TO DISCUSS THIS IMPORTANT LEGISLATION.

STATEMENT BY MR. HATCH

Mr. Chairman, I was pleased to join my colleagues, Senators Kennedy, Pell, and Stafford, as an original cosponsor of S.1817, the Education Savings Act of 1987. We all appreciate this timely hearing by the Senate Finance Committee to consider our proposal to make exempt from federal taxation the interest earned on U.S. Savings Bonds utilized to pay college tuition. I am also happy to note how many Senators, on both sides of the aisle, have since joined us in supporting this important, but simple proposal. Implementation of the Education Savings Bond proposal has also been included in the Administration's fiscal 1939 budget.

A postsecondary education is often the key to a better job and expanded opportunities. But that education can be expensive, possibly beyond the normal, unassisted reach of many families. The Education Savings Bond program can assist many families across this country to make the dream of higher education a reality for their children. Many people in my home state of Utah have expressed their intention to use it. As a matter of fact, now that it has been proposed, several Utahns have asked why we didn't think of it sooner.

To invest in U.S. Savings Bonds is easy. It is the form of investment and savings most used by those who most deserve the federal government's help in planning, saving, and investing in their children's future. To purchase a U.S. Savings Bond in order to save to finance an education is also to invest in our country and in a solid financial instrument, one we can be sure will not, over the decades, become a depleted trust fund unable to fulfill the hopes of those who have invested in it.

Mr. Chairman, I believe that the Education Savings Bond proposal is an idea whose time has come. I look forward to joining you, my colleagues on the Education Subcommittee, and all other supporters of S.1817 in working to make it a reality. Thank you again, Mr. Chairman, for holding this morning's hearing. It is an important step in implementing a program which can help ensure many children a better tomorrow.

TESTIMONY
OF
SENATOR BARBARA A. MIKULSKI
BEFORE THE
COMMITTEE ON FINANCE
EDUCATION SAVINGS ACT OF 1987
MARCH 15, 1988

MR. CHAIRMAN, I AM VERY PLEASED TO SUBMIT THIS TESTIMONY TO THE SENATE COMMITTEE ON FINANCE TODAY. THE ISSUE OF FINANCING THE COLLEGE EDUCATION OF OUR YOUNG PEOPLE IS AN ISSUE THAT WE MUST ADDRESS NOW TO PREPARE OUR CHILDREN FOR THE JOBS OF THE FUTURE.

I KNOW THAT IN MANY CASES, A YOUNG PERSON'S FIRST MORTGAGE IS THEIR COLLEGE LOAN PAYMENT. THE EDUCATION SAVINGS ACT IS JUST ONE WAY TO MAKE THAT "MORTGAGE PAYMENT" A LITTLE EASIER TO MEET.

I SUPPORT THIS BILL FOR ANOTHER REASON AND THAT IS THE ISSUE OF STUDENT LOAN DEFAULTS. WE MUST TACKLE AND ARE TACKLING THIS HARD ISSUE--WE ARE DRAFTING LEGISLATION IN THE EDUCATION SUBCOMMITTEE. WE KNOW THAT ONE REASON THIS DEFAULT PROBLEM HAS GROWN IS THAT THE LOAN BURDEN ON OUR COLLEGE STUDENT HAS INCREASED ENORMOUSLY.

THE HIGH RATE OF STUDENTS DEFAULTING ON THEIR FEDERALLY GUARANTEED STUDENT LOANS IS VERY UPSETTING. WE WANT TO ENCOURAGE STUDENTS TO PREPARE THEMSELVES FOR THE WORKFORCE IN THE YEAR 2000. ONE WAY IN WHICH WE INVEST IN THE DREAM OF FULL AND FULFILLING EMPLOYMENT IN THE FUTURE, IS THROUGH THE GUARANTEED STUDENT LOAN PROGRAM. ANOTHER WAY WE MAKE THAT INVESTMENT IS BY PROVIDING WAYS FOR PEOPLE TO SAVE FOR THAT COLLEGE EDUCATION. AS THE FEDERAL GOVERNMENT TIGHTENS ITS FISCAL BELT, WE ARE VERY CONSCIOUS OF RECEIVING A RETURN ON OUR INVESTMENT.

FOR MANY THE COST OF A COLLEGE EDUCATION IS THEIR FIRST MORTGAGE. LIKE ANY MORTGAGE, IT IS LARGE AND MUST BE PLANNED FOR AND IN MANY CASES REPAID. MR. CHAIRMAN THIS "MORTGAGE" HAS GOTTEN SO OUT OF CONTROL AND OUT OF REACH OF MANY. LET'S CONTINUE TO EXPLORE SOLUTIONS SUCH AS THE EDUCATION SAVINGS ACT.

THANK YOU, MR. CHAIRMAN FOR HOLDING THIS HEARING AND I LOOK FORWARD WORKING WITH YOU TOWARD A LEGISLATIVE SOLUTION.

Testimony Submitted for the Record By

THE HONORABLE RICHARD T. SCHULZE (R-PA)

5th District - Pennsylvania
Member - House Committee on Ways and Means

Before the Senate Committee on Finance
March 15, 1988

MR. CHAIRMAN AND DISTINGUISHED MEMBERS OF THE COMMITTEE;

I APPRECIATE THE OPPORTUNITY YOU HAVE ALLOWED ME IN ADDRESSING YOUR COMMITTEE ON THE IMPORTANT TOPIC OF INCLUDING TAX INCENTIVES FOR EDUCATION IN OUR INTERNAL REVENUE CODE. WE MUST, AS A NATION, IMPROVE OUR EDUCATIONAL INSTITUTIONS AND ACCESS TO THEM FOR OUR POPULATION. IF THE TAX CODE IS THE BEST WAY TO DO THIS, THEN CHANGES MUST BE MADE. UNFORTUNATELY, CHANGES AFFECTING EDUCATION IN THE 1986 TAX REFORM ACT PROBABLY WENT IN THE WRONG DIRECTION AND ARE, IN ONE MAJOR INSTANCE, UNFOUNDED, UNWISE, AND UNFAIR.

THE ELIMINATION OF THE DEDUCTIBILITY OF INTEREST PAID ON STUDENT LOANS WAS A MOST EGREGIOUS ERROR AND I HAVE INTRODUCED LEGISLATION IN THE HOUSE, H.R. 592, TO CORRECT THIS MISTAKE. MY LEGISLATION ENJOYS THE SUPPORT OF A LARGE NUMBER OF EDUCATIONAL INSTITUTIONS, INCLUDING THE AMERICAN COUNCIL ON EDUCATION AND THE ASSOCIATION OF AMERICAN UNIVERSITIES, AND HAS BEEN COSPONSORED BY 178 MEMBERS OF THE HOUSE. THE BROAD, BIPARTISAN SUPPORT OF H.R. 592, MANDATES THAT IT BE CONSIDERED AS A PRIMARY OPTION BY OUR TAX WRITING COMMITTEES IN RESTORING FAIRNESS AND COMMON SENSE TO OUR EDUCATION TAX POLICY. I HAVE ENCLOSED A LIST OF THOSE SUPPORTING MY LEGISLATION FOR THE HEARING RECORD.

THE DEDUCTIBILITY OF STUDENT LOAN INTEREST SHOULD BE REINSTATED FOR SEVERAL IMPORTANT REASONS. FOREMOST, IS THE NEED TO RECOGNIZE THAT INTEREST ON STUDENT LOANS SHOULD NOT, AS WAS DONE BY TAX REFORM, BE CLASSIFIED AS CONSUMER INTEREST. WHEN

INDIVIDUALS BORROW FOR EDUCATION, ITS NOT THE SAME AS BORROWING TO PURCHASE AN AUTOMOBILE, WARDROBE, OR VACATION. THE DIFFERENCE IS PROFOUND AND SHOULD BE RECOGNIZED BY THE TAX CODE. BORROWING TO PAY FOR SCHOOLING IS AN INVESTMENT, AND PERHAPS THE BEST INVESTMENT, ONE CAN MAKE FOR ONE'S FUTURE. THE RETURN ON THIS INVESTMENT TO AMERICA IN INCREASED PRODUCTIVITY AND EVENTUAL TAX REVENUES PROBABLY OFFSET THE INITIAL REVENUE SUBSIDY.

SECONDLY, AS STRUCTURED NOW, LOAN INTEREST FOR UPPER-INCOME TAXPAYERS CAN BE DEDUCTIBLE ON CONSUMER PURCHASES UTILIZING HOME EQUITY LOANS, BUT NOT BY RENTERS OR LOWER-INCOME TAXPAYERS. THIS IS A PROFOUND DISCREPENCY IN TAX POLICY FAIRNESS.

FINALLY, THE HUGE COSTS FOR OUR MOST IMPORTANT SCIENTIFIC AND ADVANCED DEGREES RESULT IN ENORMOUS INTEREST PAYMENTS. THESE PAYMENTS ARE USUALLY DEFERRED UNTIL THE STUDENT IS WORKING, AND OFTEN REACH PROPORTIONS EQUAL TO NEARLY HALF A GRADUATE'S INCOME. ONE MINORITY STUDENT, WRITING TO ME FROM TEMPLE UNIVERSITY MEDICAL SCHOOL, DETAILED A FINANCIAL DEBT OF NEARLY $100,000 FOR HIS UNDERGRADUATE WORK AND MEDICAL TRAINING. INITIAL PAYMENTS ON SUCH LOANS, WHILE USUALLY DEFERRED, CONSIST MAINLY OF INTEREST. THE INTEREST PAYMENTS ON $100,000 OF DEBT, FOR A $23,000 A YEAR JUNIOR RESIDENT ARE PROHIBITIVE. ALLOWING A TAX DEDUCTION FOR THIS INTEREST COULD ACTUALLY BE A MATTER OF ECONOMIC SURVIVAL FOR THOUSANDS OF HIGHER EDUCATION GRADUATES.

MR. CHAIRMAN, STUDENT LOAN INTEREST IS NOT CONSUMER INTEREST, BUT SHOULD BE CLASSIFIED AS INVESTMENT INTEREST, AND SHOULD BE MADE FULLY DEDUCTIBLE. THE CURRENT LIMITATIONS ON LOAN DEDUCTIBILITY ARE ANTI-COMPETITIVE, DISCRIMINATE AGAINST LOWER INCOME TAXPAYERS, AND LIMIT ACCESS TO HIGHER EDUCATION. WHILE I WOULD STRONGLY RECOMMEND ADDITIONAL TAX INCENTIVES FOR EDUCATION, INCLUDING COLLEGE SAVINGS ACCOUNTS, AND PERHAPS TAX-FREE EDUCATIONAL SAVINGS BONDS, RESTORING THE DEDUCTIBILITY OF STUDENT LOAN INTEREST EXPENSE SHOULD BE THE FIRST STEP IN ADJUSTING OUR TAX CODE IN FAVOR OF EDUCATION. I URGE YOUR COMMITTEE TO ACT

UPON COMPANION LEGISLATION TO H.R. 592, S. 628, INTRODUCED BY SENATOR GRASSLEY.

THANK YOU.

ADDENDUM

H.R. 592 and S. 628 have been endorsed by the following groups:

American Council on Education
American Dental Association
Assocication of American Medical Colleges
Marquette University
American Student Dental Association
University of Pennsylvania
Council of Independent Colleges
Association of Urban Universities
American Association of Community and Junior Colleges
American Association of State Colleges and Universities
Association of Catholic Colleges and Universities
Association of Jesuit Colleges and Universities
National Association of Student Financial Aid Administrators
National Association of Independent Colleges and Universities
Nat'l Assoc. of Schools & Colleges of the United Methodist Church
National Association State Universities and Land-Grant Colleges
National Association of Equal Opportunity in Higher Education
Association of American Universities
University of Pittsburgh
American Association of Dental Schools
Medical College of Pennsylvania
United States Student Association

178 Members of Congress who have cosponsored H.R. 592

Armey
Atkins
Badham
Bateman
Bentley
Biaggi
Bilbray
Bilirakis
Bliley
Boehlert
Borski
Boxer
Brennan
Brown (CO)
Buechner
Bunning
Bustamante
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Campbell
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Clinger
Coble
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Combest
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Coughlin
Coyne
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Daub
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de Lugo
Dellums
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Gilman
Goodling
Gordon
Grandy
Gray (Ken)
Hall (OH)
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Horton
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Kolbe
Kolter
Konnyu
Kostmayer
Lancaster
Leath
Lehman (FLA)
Leland
Lagomarsino
Lent
Lewis (John)
Lightfoot
Livingston
MacKay
Manton

Markey
Marlenee
Martin (NY)
Martinez
McCollum
McKinney
McMillen (MD)
Mfume
Moakley
Mollahan
Morella
Mrazek
Murphy
Neal
Neilson (UT)
Oakar
Olin
Owens (UT)
Owens (NY)
Packard
Panetta
Parris
Penny
Perkins
Porter
Price
Rahall
Rangel
Ravenel
Rhodes
Ridge
Rinaldo
Ritter
Roe
Rogers
Roth
Roukema
Rowland (CT)
Russo
Savage
Saxton
Scheuer
Schuette
Shaw
Sikorski
Skaggs
Skeen
Smith (NE)
Solarz
Staggers
Stangeland
Stokes
Studds
Swindall
Sunia
Tallon
Torres
Torricelli
Towns
Valentine
Vento
Volkmer
Vucanovich
Walker
Weiss
Weldon
Whittaker
Wilson
Wise
Wolf
Wortley
Yatron
Young (AK)
Young (FL)

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DEPUTY CHIEF OF STAFF

Congress of the United States
JOINT COMMITTEE ON TAXATION
1015 LONGWORTH HOUSE OFFICE BUILDING
Washington, DC 20515-6453

OCT 8 1987

Honorable Daniel P. Moynihan
United States Senate
Washington, DC 20510

Dear Senator Moynihan:

This is in response to your request for a revenue estimate for a proposal to make permanent the exclusion from income of amounts paid for employer-provided educational assistance (section 127). The following estimate is provided assuming that the provision is effective for taxable years beginning after December 31, 1987.

Fiscal Years (Billions of Dollars)				
1988	1989	1990	1991	1992
-0.2	-0.2	-0.2	-0.3	-0.3

I hope you find this information useful. Please contact me if you need further assistance.

Sincerely,

David H Brockway

David H. Brockway

100TH CONGRESS 1ST SESSION

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Congreſs of the United States
JOINT COMMITTEE ON TAXATION
1015 LONGWORTH HOUSE OFFICE BUILDING
Washington, DC 20515-6453

DAVID H. BROCKWAY
CHIEF OF STAFF

RANDALL D. WEISS
DEPUTY CHIEF OF STAFF

NOV 16 1987

Honorable Edward M. Kennedy
United States Senate
Washington, DC 20510

Dear Senator Kennedy:

This is in response to a request by Shirley Sagawa for a revenue estimate of a bill which would make interest on U.S. savings bonds tax exempt for those bonds which are transferred to an educational institution as payment for tuition and fees. For taxpayers with adjusted gross income (AGI) between $75,000 and $125,000, 67 percent of the interest would be exempt, for those with incomes between $125,000 and $150,00, 34 percent would be exempt, and no exemption would be available for taxpayers with incomes of $150,000 or more. These income figures would be adjusted for inflation. Dependents would apply the income phase-out by taking into account the income of the taxpayer providing the support. The tax exemption would apply only to transfers of savings bonds issued after the date of enactment.

The following estimate assumes an enactment date of January 1, 1988.

Fiscal Years
(Billions of Dollars)

1988	1989	1990	1991	1992
*	-0.1	-0.1	-0.2	-0.3

I hope this information will be helpful to you. If we can be of any further assistance, please do not hesitate to let me know.

Sincerely,

David H. Brockway

COMPARISON OF MAJOR EDUCATION SAVINGS PLANS

	Kennedy-Pell Savings Bond Plan	Educational Savings Accounts	State Tuition Futures
Summary	Uses existing U.S. Bonds, which are transfered to educational institution as tuition payment.	Contributions are made to savings accounts; withdrawn when beneficiary enters college and used to pay tuition and fees.	State creates pre-payment mechanism (i.e. a trust) that allows families to pay tuition years in advance of enrollment.
Tax Status	Interest on bonds is tax-free if used for tuition and fees.	Contributions and/or interest tax-free.	Value of tuition minus amount of pre-payment not taxable.
Flexibility	Can be used at any higher education institution.	Can be used at any higher education institution.	May or may not have to be used within state.
Risk	If child does not attend college bond may be used for any purpose; only tax benefit is lost.	If child does not attend college funds may be used for any purpose; only tax benefit is lost.	If child does not attend college, only initial contribution is refunded.
Program	Creates no new bureaucracy.	May require significant monitoring effort.	Creates state bureaucracy; not practicable at national level.
Parental Effort	Buy Bond. Can payroll deduct.	Must set up account.	Must enroll.
Cost	Minimal tax-revenue loss years in the future.	Tax credit for contributions represents significant loss of tax revenue.	State assumes risk that contributions plus investment earnings will cover future costs.
Benefit	Encourages sale of U.S. Savings Bonds.		

COLLEGE SAVINGS BONDS:
PROPOSAL FEATURES AND COST ESTIMATES

	Alternative I	Alternative II	Alternative III	Kennedy-Pell Bill
Feature		Proposal Overviews		
Income cap	o Bond interest tax free below $40,000; tax benefit phased out between $40,000 and $60,000; no benefits above $60,000.	o Same as Alternative I, but phaseout of tax benefits between $60,000 and $80,000; no benefits above $80,000.	o Same as Alternative II.	o Bond interest tax-free below $75,000; tax benefit phased out between $75,000 and $125,000 no benefits above $125,000.
Use of bonds	o Eligible bond interest for tuition and fees only-not to exceed $5,000.	o Same as Alternative I.	o Eligible bond interest for tuition and fees and room and board.	o Eligible bond interest for tuition and fees, books and supplies (but not for room and board).
Years		Cost Estimates (millions)		
1989	$10	$12	$13	$17
1990	$46	$56	$59	$77
1991	$101	$123	$130	$169
1992	$150	$183	$194	$251
1993	$199	$243	$257	$332
1994	$263	$321	$339	$439

STATEMENT OF ABRAHAM RIBICOFF, SPECIAL COUNSEL
KAYE, SCHOLER, FIERMAN, HAYS & HANDLER

Senate Finance Committee
March 15, 1988

Mr. Chairman and Members of the Committee, I am pleased to have the opportunity this morning to testify in support of tax incentives for education. I speak today in behalf of Senator Moynihan's bill S. 39, the "Employee Educational Act of 1987," co-sponsored by 33 members of the Senate, which would restore Section 127 of the 1978 tax reform act.

I appear today on behalf of the Morgan Bank, and I ask that a statement by Mr. Herbert J. Hefke be placed in the record at the conclusion of my remarks. Mr. Hefke is Senior Vice-President and Director of Human Resources at the bank. His statement provides a first-hand account of the successes of the program in upgrading employee skills, in providing educational opportunities for employees, and in the aggressive pursuit of affirmative action opportunities for minority employees and women.

The safest and most consistent political buzz words during the current 1988 campaign for all Presidential and Congressional candidates are competitiveness and education. That is really what Senator Moynihan's bill is really all about.

Morgan's experience demonstrates that this program is of paramount importance to lower-paid employees, women, and minorities. As Mr. Hefke notes in his testimony, 66% of program dollars go to workers earning less than $40,000 -- 90% of the program dollars go to workers earning less than $50,000. Of total participants in 1986 and 1987, 58% were women -- 33% were minorities.

This experience is repeated throughout the United States. According to a 1985 study prepared by the American Society for Training and Development, 95.4% of participants in Section 127 programs earned less than $50,000 -- 71.1% earned less than $30,000. At a recent conference sponsored in part by the Congressional Competitiveness Caucus ("Working Better: Building Consensus for a More Effective Workforce," June 30, 1987), representatives of labor, business, academia, and government joined in urging support for Section 127. Citing the experience of General Motors, where some 119,000 laid-off workers are now being retrained for careers outside the automobile industry, a labor spokesman pointed out that the training provided under Section 127 can sometimes spell the difference between having a job -- and having no job at all. For such workers, losing the tax exemption provided by Section 127 would be especially burdensome.

This experience should put to rest any notion that this program is a fringe benefit for rich workers. It is not. The overwhelming majority of people who participate in this program are working men and women who need this assistance in order to get the training they need to move up the career ladder. This is a popular program. In a 1986 survey of the Fortune 1000 companies, 715 of the 730 companies responding said that they maintained a tuition reimbursement program for their employees. In all, it is estimated that seven million workers have participated in educational assistance programs under Section 127. This program has been tremendously successful in providing training opportunities for workers at the lower wage scales -- the very people we sought to assist when we created this program.

As you will recall, when we approved the 1978 tax reform bill, we observed that "the tax law ... requires out-of-pocket tax payments for employer-provided educational assistance from those least able to pay." For these reasons, we stated that the tax law served as a "disincentive to upward mobility." The experience of the Morgan Bank and others demonstrates that - for many workers - this program has been successful in removing the barriers to upward mobility created by the tax law. With the expiration of Section 127 we are faced once again with the very situation we so roundly condemned only ten years ago. Moreover, this problem recurs at a time when the government should be doing everything possible to encourage workers to improve their skills.

This Committee has always been at the cutting edge. I do not need to remind you of the challenges facing this country. The current national debt exceeds $2.4 trillion. The budget deficit this year is expected to run anywhere from $144 to $157 billion. Our balance of trade deficit will be in excess of $171 billion. For the first time since 1917, the United States is a debtor nation. According to all of the leading economic indicators, we have descended into an ever deepening sea of red ink. We will not be able to stop this nation's decline toward the status of a second rate economic power unless and until we retrieve the competitive edge over other world economic powers.

In his excellent book, The Rise and Fall of the Great Powers, historian Paul Kennedy writes that a critical strength of the Japanese is "the very high quality of the Japanese work force...which is not only groomed in an intensely competitive public education system but also systematically trained by the companies themselves.

> Even fifteen-year-olds in Japan show a marked superiority in testable subjects...over most of their western counterparts.... Japan...produces many more engineers than any western country (about 50% more than the United States itself). It also has nearly 700,000 R&D workers, which is more than Britain, France, and West Germany have combined."

This is the competition we face. If we are to meet this competition, we must provide continuing support for proven programs that provide training for American workers.

I understand that Section 127 has been estimated to cost $200 million a year, and I sympathize with your dilemma as you seek to find ways to retrieve a projected $200 million revenue loss. However, just the opposite is the case.

The fact of the matter is that Section 127 will bring in more revenue. Employees receiving an education increase their skills -- and as they increase their skills they also upgrade their jobs and salaries. These workers will more than make up the cost of their training in the higher taxes paid on their higher income.

Mr. Hefke's statement discusses three examples from the experience of the Morgan Bank that demonstrate this point. A secretary who obtained her undergraduate degree through the Morgan tuition refund program is now an assistant vice-president, making twice the salary she would have made had she remained in her secretarial position. A messenger who began participating in the tuition refund program after joining the clerical staff was appointed an officer soon after obtaining his degree, and is now earning almost at double the salary he would have earned in a normal clerical career path. A former mail clerk who worked his way through the ranks obtained an undergraduate degree in business administration and now earns in excess of $100,000 as a vice president of the bank.

To assess the tax ramifications of such success stories I asked the tax department of my law firm to analyze the hypothetical case of a clerical employee, who earned between $20,000 and $24,000 during five undergraduate years (1978-82), but secured new responsibilities upon graduation in 1982 and is now earning

$55,000 per year. Assuming no dependents or other income and applying the standard deduction, this employee will have paid about $13,500 in federal income taxes for 1987 alone -- almost $9,000 more than the taxes paid if the employee had remained in a clerical position and were now earning $29,000.

Assuming this employee had received $1,800 in tuition reimbursements for each of the undergraduate years, the total tax forgone by the government over five years would have amounted to some $3,090, or only one-third of the total increased tax which the employee paid in a single year as a result of this education. In fact, using reasonable assumptions, we calculate that, over the five-year period 1982 through 1987, the federal government would realize a 900% return on its initial tax "investment" in this employee -- receiving more than $28,000 in additional taxes as a result of the employee's improved education. Even if a reasonable interest rate were taken into account in calculating forgone revenues, the return on investment would exceed 500%.

Over the employee's working life, it is clear that the modest investment under Section 127 would be repaid many times over in increased taxes.

Admittedly, this is a rough cut analysis. For some workers, the projected tax revenues would be less than the example chosen -- for others, the tax revenues would be higher. It is fair to assume, however, that -- for most workers -- the increased training made possible by Section 127 translates into higher adjusted gross income -- and higher taxes. When this information is taken into account, the projected losses attributed to Section 127 evaporate.

By contrast, if this program is allowed to die, many workers will be forced to abandon their education. It is also important to keep in mind that these programs rarely approach being a "free ride." Many workers already spend a good deal of their own money for books and tuition, with employer assistance picking up only a fraction of the cost. Adding a tax burden on top of these costs may cause many workers to forego or postpone their educations. To the extent workers drop out of these programs, no tax revenue is generated. More important, the opportunity is lost or delayed to enhance the competitive skills of the workforce.

This program also succeeds in providing training opportunities to workers without the bureaucracy and costs attendant to the administration of grants programs. It enables employers and employees alike to choose the kind of training program that best suits employee needs, and allows employees and employers to set the pace of their training, an important consideration for employees who often must juggle their educational program with work and family commitments. To the extent that it becomes necessary to substitute direct grants for Section 127, this flexibility is lost. Furthermore, it is obvious that Section 127 can provide educational assistance to workers at a fraction of the cost of direct aid programs, since the employers and the employees themselves pick up the lion's share of the cost, including the administrative costs of the program.

For these reasons, I sincerely hope that you will give careful consideration to the renewal of Section 127. It is a successful program, and worthy of your support. The task of keeping this country competitive is too important to allow this program to expire.

I ask that a recent New York Times article discussing the impact of Section 127 be inserted at this point in the record.

I am available to answer any questions that you may have.

The New York Times

NEW YORK, WEDNESDAY, FEBRUARY 24, 1988

A Career-Improvement Tax Break Ends

By LEE A. DANIELS

After becoming a telephone service representative four years ago, Tanya Davis took several courses in journalism and magazine publishing to pursue her dream of a career in the field.

Her quest was helped by the tax-free reimbursement from her employer, New York Telephone, for her course fees at New York University's School of Continuing Education.

But Ms. Davis put her dream on hold in December, with the expiration of the Federal program that had allowed the tax-exempt payments for any kind of educational courses.

The lapse of the program, under which employers were paying at least $70 million annually in tuition, affects millions of workers, particularly those at the lower end of the wage scale. While companies can continue to reimburse employees for educational courses, the workers have to include the money as taxable income.

Used by Millions

The expected drop in the number of people taking courses under those circumstances could have a sharp impact, especially on two-year colleges, which many people attend part time, and on such four-year institutions as N.Y.U. that offer a broad variety of continuing-education programs.

More than seven million workers, most with salaries below $30,000, have used the tax provision for educational courses over its nine-year history, according to the American Society for Training and Development, a Washington-based organization of training professionals. Some companies have used the provision to retrain workers due to be laid off.

Under the provision, people enrolled in courses — even some not related to the job — paid for them, then were reimbursed by their companies when they got their grades.

Companies have varying rules and limits, but Ms. Davis, who earned a bachelor's degree in English from Rutgers University in 1981, was able to receive up to $1,825 a year.

Reimbursement for part-time studies is now counted as income.

If she were to continue, she would have to pay $530 more in Federal taxes on the money she received from the company, and that is an added tax burden she says she cannot handle on her $30,000 salary.

"The phone company's been excellent about supporting me, but I can't afford it now," said Ms. Davis.

Company payment for job-related courses, a far more restrictive category, is still tax free.

Supporters of reimbursement are confident the tax exemption will be renewed, although few will make any predictions this election year.

Support in Congress

Representative Frank J. Guarini, a New Jersey Democrat who is the lead House sponsor of a measure that would make the provision a permanent feature of the tax code, said: "There is no question Congress wants this program. I've got over 200 cosponsors thus far."

Support appears equally strong in the Senate, where a measure sponsored by Senator Daniel Patrick Moynihan, Democrat of New York, has more than 40 cosponsors. Congress has renewed the provision by large margins the two previous times it has expired.

Colleges and universities, labor unions and corporations are also pushing strongly for the provision's renewal. "The lapse is already causing problems," said Gregory A. Humphrey, director of legislation for the American Federation of Teachers.

Mr. Humphrey, co-chairman of the Coalition for Employee Educational Assistance, and representatives of the National Association of Manufacturers and the American Association of Community and Junior Colleges said that the Presidential campaign and concern about the deficit have muddied the situation.

'A Distressing Signal'

Aaron Feinsot, Dean of Professional and Industry Programs at New York University, said even the temporary lapse of the program "is a distressing signal to people who are pushing to improve their skills. It seems hypocritical, especially with so much emphasis on increasing American competitiveness.

The benefit of the program was established by a 1985 study of the American Society for Training and Development. The study reported that nearly a fourth of workers taking advantage of the program earned less than $15,000 a year, and 50 percent earned less than $30,000 annually. More than 90 percent took courses to improve job skills.

The average amount of tuition aid per worker under the program totaled $491.

John Robinson, a spokesman for Motorola Inc., which has 97,000 employees worldwide, said that more than 3,900 of its United States employees have taken courses. "It's been very beneficial for our employees, and for us, too," he said, "because the employees bring their new skills back to the workplace."

STATEMENT OF HERBERT J. HEFKE, SENIOR VICE PRESIDENT, MORGAN GUARANTY TRUST COMPANY OF NEW YORK

Senate Finance Committee

March 15, 1988

On behalf of the Morgan companies, including Morgan Guaranty Trust Company of New York, I would like to thank the Chairman and Members of the Committee for the opportunity to submit this statement in support of S.39, introduced by Senator Moynihan, which would restore and make permanent Section 127 of the Internal Revenue Code, permitting employees to receive employer-provided educational assistance, without the assistance being considered part of the employees' taxable income.

We at Morgan are committed to the purposes served by employer-provided educational assistance programs. Programs like ours provide critical assistance to employees who seek to upgrade their skills. Our own Tuition Refund Program reflects our conviction that better education creates a more productive working environment and a more efficient and effective workforce. In our view, financial incentives for education and training are essential to maintaining a vital and competitive economy, as well as to preserving the "American Dream".

The basic elements of Morgan's Tuition Refund Program are typical of the kinds of educational assistance provided by the other major corporations and financial institutions. Our program is open to all full-time employees with at least six months' service and provides reimbursement for approved courses leading to undergraduate or graduate degrees and job-related certificates. Participating employees must receive a grade of at least "C" or better (or a passing grade for a "Pass/Fail" course) to qualify for reimbursement.

Just over 500 employees participated in Morgan's Tuition Refund Program in 1987; a similar number participated in 1986. These employees enrolled in courses at over sixty different private and public colleges and universities, as well as in special certificate and other programs such as those offered by the American Institute of Banking -- the educational affiliate of the American Bankers Association, of which Morgan is a supporting member. About seventy-one percent of Morgan's total program participants in 1986 and 1987 pursued courses at the undergraduate level; the remainder were enrolled in graduate level classes.

Our own experience shows that Section 127 educational assistance is not a benefit enjoyed primarily by highly compensated employees but instead provides needed encouragement and financial assistance chiefly to employees in the low to moderate income brackets. During the first three quarters of last year, almost 90% of the dollars reimbursed to New York-based employees under Morgan's Tuition Refund Program were provided to individuals earning less than $50,000 per year and more than 65% to individuals earning less than $40,000 per year. This was true despite the fact that New York salaries are among the highest in the country and the fact that, as a commercial bank, our workforce includes a relatively smaller number of clerical and other lower-income employees. I am confident that for other employers, a similar, if not higher, proportion of total educational assistance is received by employees in the lower income brackets. Indeed, a 1985 survey of over 300 public and private employers conducted by the American Society of Training and Development reported that more than 95% of Section 127 educational assistance program participants earned less than $50,000 per year and more than 71% earned less than $30,000.

The fact is that low to moderate income employees are the primary beneficiaries of Section 127 and it is they who will be most seriously affected if Section 127 is not restored. These are the employees who have the greatest need for additional training and education, who can least afford a reduction in their take-home pay, and who are most likely to be taxed on their educational assistance under current law. These compelling facts should not be ignored in assessing the true impact of employer-provided educational assistance.

Equally compelling, in our own view, is the importance of educational assistance in securing upward mobility for members of historically disadvantaged groups. Morgan is deeply committed to equal employment opportunity and the Tuition Refund Program is an integral part of our affirmative action efforts. Educational assistance enables employees to expand their promotional opportunities, enlarge their responsibilities and accelerate their income. This is particularly important for minorities and women who may have begun their working careers in clerical or secretarial positions with only a high school education and little knowledge of general business systems and practices, not to mention sophisticated financial analysis, data systems or investment strategies. For such employees, the best opportunity for rapid career change lies in securing the kind of education available to them through the Tuition Refund Program.

We are encouraged that one-third of Morgan's total program participants in 1986 and 1987 were minorities and that 58% were women. We are concerned about the impact that the expiration of Section 127 may have on these employees' career aspirations and continued pursuit of higher education. Particularly worrisome is the impact which Section 127's expiration may have on recent graduates of our deteriorating inner-city public schools. Many of these individuals have graduated from high school without either the grades or the study skills to gain entrance to college. Only through special employer-reimbursed certificate programs like those provided by the American Institute for Banking are they able to acquire the skills and demonstrate the motivation which accredited colleges and universities demand. Fully 70% of the 4,000 students enrolled in A.I.B.'s evening certificate programs are minorities and 60% are women. For these employees, employer-provided assistance is critical to their continued pursuit of educational objectives.

The Morgan companies are very proud that hundreds of our employees have obtained their undergraduate and graduate degrees through Morgan's Tuition Refund Program. The program has had a very real impact on the lives of our employees. A few concrete examples will show the kinds of results that have been achieved. One Morgan employee, who began her career in a secretarial position, obtained her undergraduate degree five years ago through our Tuition Refund Program and is now employed as an Assistant Vice President in a core business area. If she had remained as a secretary, she would probably be earning about $30,000 today. With her new responsibilities and improved skills, she is earning almost double that amount. A minority group member who came to Morgan as a messenger, soon entered our clerical staff and began participating in the Tuition Refund Program. Shortly after he earned his bachelor's degree in management, he was appointed an entry-level officer of the Bank. He is currently employed as an Assistant Vice President with significant management responsibilities, earning salary and bonus which exceed by $30,000 the annual compensation of about $29,000 he might have expected if he had continued in a normal clerical career path. Another employee who began in our mail room later worked his way through the clerical ranks to a project-manager level. While working in that position, he obtained an undergraduate degree in business administration and is now employed as a Vice President in an important systems area. This employee is now earning in excess of $100,000 annually, more than tripling the salary he would probably have been earning today if he had remained a project manager.

While employees like these have obviously benefited from the Tuition Refund Program, we at Morgan have also benefited from their continued services and enhanced skills. Even the United States Treasury has benefited from their education. The fact is that promotions mean higher salaries and higher salaries mean more tax revenues. Employees who improve their positions not only repay the cost of their educational "tax benefit" within a very short period, but do so while remaining fully productive, income-generating, taxpaying employees.

Educational assistance is a good investment in every conceivable sense and like any good investment, it yields a substantial return. On behalf of the Morgan companies, I urge you to restore and make permanent Section 127 of the Internal Revenue Code. We would be pleased to provide any additional information you may need concerning the operation and success of our Tuition Refund Program. I thank you for the opportunity to present Morgan's views on this important legislation.

STATEMENT
OF
GOVERNOR JAMES J. BLANCHARD

Mr. Chairman and Members of the Senate Finance Committee:

Thank you for this opportunity to appear before you today to discuss Michigan's first-in-the nation college tuition guarantee program -- the Michigan Education Trust (MET). Every state, every local government and the federal government must be deeply committed to investing in our children through a blend of education programs. In Michigan, over the last five years, we have increased need-based scholarships by over 150 percent. Over that same period of time, our investment in higher education has increased by 53 percent. We have also launched a high school dropout prevention program in which the state pays for two years of community college for needy students. And, we have added MET to the list of innovative programs aimed at helping children receive the education they will need to be productive members of our society in the 21st century. This investment in our future is crucial for a competitive nation.

We developed MET as a program which would offer hope and motivation to kids in Michigan. MET assures children that college tuition is guaranteed and gives them a reason to stay in school and graduate. And we developed MET in response to a growing need to help our citizens afford college for their children. Over the past two decades, students have faced skyrocketing tuition costs. They have met this unchecked tuition burden with greater and greater amounts of personal debt. That assumption of tremendous personal debt, coupled with a growing federal deficit, places this generation in far different circumstances than we faced just 20 years ago. Children born this year face even a starker reality. When they are ready to enroll in college, four years of college tuition alone could cost approximately $30,000.

As a nation, we must do everything possible to provide for our children. We must be innovative to meet the spiraling cost of college and we cannot ask students to mortgage their future to attend college.

Michigan Education Trust (MET)

We modeled our program after the "I have a dream" program developed by Eugene Lang for students at his alma mater in East Harlem. He promised all of the students in the 6th grade that if they worked hard, studied, stayed in school and graduated, he would pay for their college tuition. And it worked. In a school where the dropouts averaged around 90%, there were almost no dropouts and one-half of those students are now going to college.

We hope that our tuition guarantee program will achieve the same results as the program initiated by Eugene Lang. I want Michigan to be a leader in the nation in access to higher education. I want to make sure we're dealing with the skyrocketing debts students face. I want to make sure we are opening up opportunities in the future we haven't before, by letting people provide, through prepaid tuition, that opportunity and letting the state be a catalyst. And I want to see us offer hope and motivation. I believe that a child's name on a tuition guarantee -- right there on a piece of paper can, if it's explained periodically, offer more incentive than all the platitudes about free enterprise and freedom that you can find.

A certificate of tuition guarantee with a child's name on it, and which tells them if they work hard and strive to achieve they are going to be able to go to college can be a wonderful motivator and tremendous encouragement to young people to work hard and have their hopes and dreams fulfilled.

How MET Works

Our program allows parents, grandparents and others to make a one-time lump sum payment or periodic fixed payments to prepurchase and guarantee college tuition for a child. MET will pool the funds collected, invest them and pay the tuition costs for each child at the school of their choice when they are ready to attend college.

Once a parent signs a contract for the program at a specified cost, that parent will never have to contribute additional funds, regardless of what tuition costs may be. The parents have the peace of mind that their child's college tuition costs are completely covered. Therefore, MET will assume two types of risks. First, MET must make projections regarding the expected rate of tuition inflation. In addition, MET will project the expected rate of return on the invested funds. These two assumptions, detailed in the attached tables, are the crux of how MET will work.

The Michigan Education Trust offers many advantages:

- First and foremost, it guarantees tuition, not merely a rate of return or a future sum of money. MET does not act as a mutual fund for parents -- it acts as the agent for the State to guarantee tuition for the State's citizens. As I stated earlier, the State of Michigan must provide education for all of our citizens and MET is the best vehicle to accomplish that. It is this guarantee feature which distinguishes the program from any of its counterparts in the private sector.

- Second, MET provides flexibility and portability to the student. Students select the college they wish to attend and they don't have to make the selection until they are ready to go to college. Moreover, a student with a contract under MET can use it at any college in the country -- public or private. If they attend a Michigan public university, as 212,000 or 90% of all Michigan college students do, the full tuition is guaranteed. Should they choose to attend any other college anywhere in this country, however, funds equal to the average tuition rate at a Michigan college will be forwarded to the college of their choice.
- Third, in Michigan, we have added tax deductibility on the state income tax forms as a further incentive.

Other Programs

The Michigan program has been duplicated in five other states: Wyoming, Maine, Florida, Indiana and Tennessee. Two other states, North Carolina and Illinois, have adopted a slightly different program -- the savings bond approach -- as their method for helping parents wrestle with the problem of higher education costs. And in 34 other states, legislation is pending or commissions have been appointed to study the problem and to offer solutions. The chart accompanying my testimony illustrates the tremendous interest in tuition programs. In short, nearly every state is interested in helping children get in school, stay in school, and attend college.

I should add that each state must develop a program tailored for that state. In Michigan, guaranteeing tuition addresses the concerns of our citizens. In other states, a different proposal may be more appropriate. And while states may understandably use different solutions to solve similar problems, we are heartened that proposals are being discussed in all but 8 states.

MET Status

What many states are awaiting, and what we have been waiting for since last February, is a revenue ruling from the Internal Revenue Service. Our state law requires a favorable ruling from the IRS regarding the purchaser of the MET contract. A favorable ruling on that aspect will permit Michigan and other states to go forward and offer contracts to the thousands upon thousands of interested citizens.

Federal Government

As you know, several Senators and Congressmen have introduced federal legislation which would institutionalize at the federal level a tuition guarantee program or a college savings bond proposal.

We were also encouraged when Vice President Bush's program for savings bonds for education was included in the 1988-89 budget. This inclusion indicated to us that this Administration was also serious about innovative programs to help pay for college.

Federal Tax Revenue

In Michigan, we decided to create tax incentives for this program. We decided that some tax expenditures were well worth it to help children get a fair chance. And that same budgetary impact was tolerable to help parents address the top concern of paying for college. In Michigan, however, we have a balanced budget. We understand that the analysis may be different in Washington.

So, we commissioned Coopers and Lybrand to conduct an analysis on the overall federal tax implications of such a program as the MET.

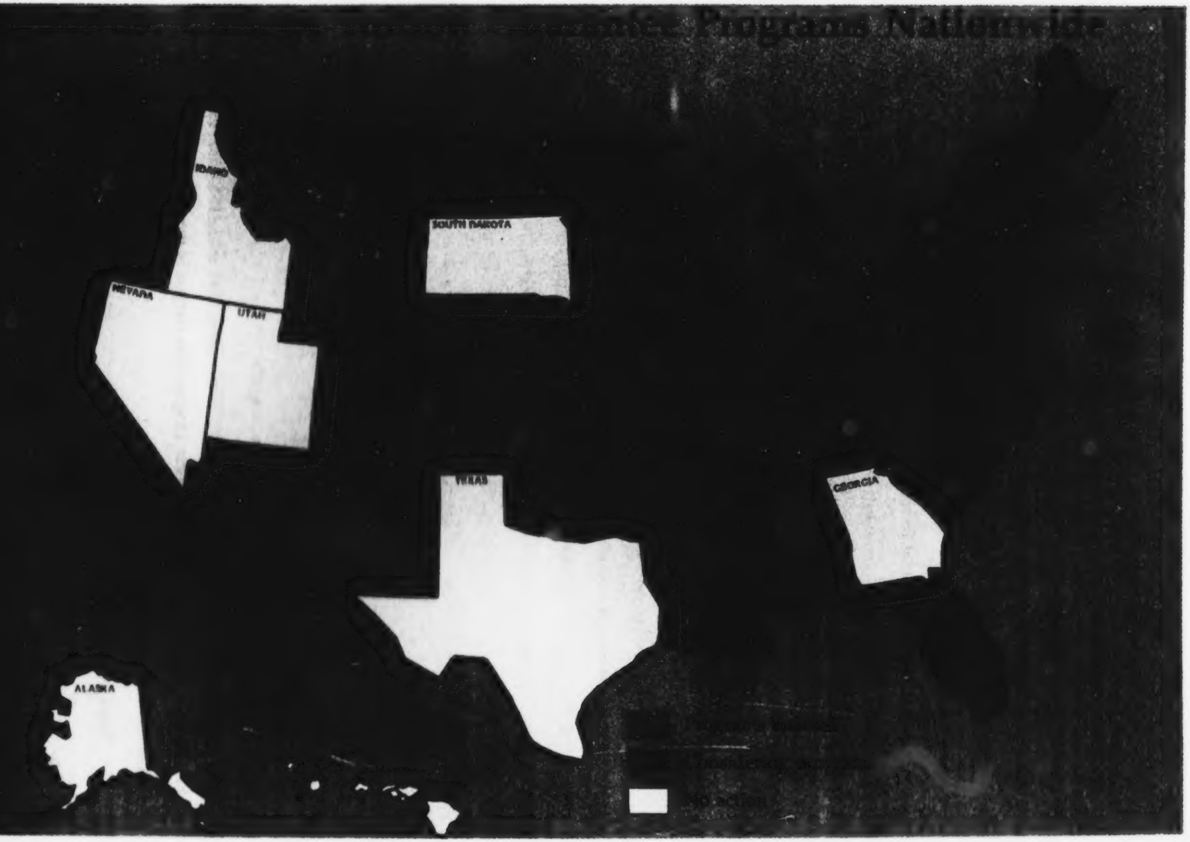
Their analysis showed that if just 4 percent more children attended college, then the federal government would be net winners in tax revenues. The reason is simple: better educated people get better paying jobs and, therefore, pay more in taxes. Moreover, if children stay in school, they are less likely to need public assistance or cause other forms of budget expenditures. Not only can programs like MET meet important social and human concerns, but they will also generate net tax dollars for the U.S. Treasury.

Conclusion

The Michigan Education Trust, and other programs like it, are a crucial weapon in our never ending effort to provide top-notch, affordable education for our children. It does not replace, rather it complements, existing student grant and loan programs. But MET is a significant step toward helping parents help their kids. Our view in Michigan is that the only thing better than one Eugene Lang in East Harlem is thousands and thousands of Eugene Langs nationwide.

Thank you, Mr. Chairman.

[illegible] Programs Nationwide


IDAHO
SOUTH DAKOTA
NEVADA
UTAH
TEXAS
GEORGIA
ALASKA
[illegible]
[illegible]
No action

Other State Initiatives

State	Tuition Guarantee	Savings Bond/ Account	Conducting Study	Comments
Alabama				Pending legislation modelled after the MI plan.
Alaska				No pending legislation
Arizona			X	No pending legislation Awaiting MI IRS ruling
Arkansas			X	No pending legislation
California	Vetoed by Governor.			Planning to reintroduce legislation.
Colorado				Legislation pending, modelled after IL savings bond program.
Connecticut				No pending legislation Working on language based on IL plan.
Delaware				Completed study, will wait before pursuing any programs.
Florida	Enacted			Plan to offer contracts in May.
Georgia				No pending legislation
Hawaii				No studies or pending legislation.
Idaho				No pending legislation or studies.
Illinois	Vetoed by Governor.	Enacted		$90 million bond issue in January.
Indiana	Enacted			Pending IRS ruling; plan to seek legislative amendments.
Iowa			X	Legislation has been drafted modelling IL plan.
Kansas				Legislation has been introduced modelling MI plan.
Kentucky			X	Legislation still pending. Reported favorably with committee amendments.
Louisiana				Legislation died last year. Awaiting MI IRS ruling.

State	Tuition Guarantee	Savings Bond/ Account	Conducting Study	Comments
Maine	Enacted			Pending IRS ruling.
Maryland			X	Governor has proposed savings subsidy program. One percent of principal reimbursed if child attends Maryland college.
Massachusetts				Proposal modelled after MI and IL plans; requires legislation.
Minnesota			X	Awaiting Congressional action. 3/1 Governor introduced legislation for savings bond program.
Mississippi				Pending legislation 6-8 different types modelled after IL, MI, and MA plans.
Missouri				Legislation pending for tuition guarantee and savings plans.
Montana				Recently completed report from Board of Regents. Governor impressed w/Michigan plan. No pending legislation.
Nebraska			X	Recently introduced legislation.
Nevada				No pending legislation or studies.
New Hampshire				Pending legislation dying in committee. College Presidents oppose any type of program.
New Jersey				Legislation has been reintroduced. Allows purchase of tuition credit at present rates.
New Mexico				Awaiting MI IRS ruling
New York				Study recently completed.
North Carolina		Enacted		General zero coupon bond program.

State	Tuition Guarantee	Savings Bond/ Account	Conducting Study	Comments
North Dakota				Drafting legislation.
Ohio				No pending legislation Awaiting MI IRS ruling
Oklahoma				Pending legislation modelled after MI plan
Oregon		X		Plan modelled after IL. Plan to reissue existing zero coupon bonds by 4/88. Preparing legislation for next year.
Pennsylvania				New legislation introduced similar to MA plan.
Rhode Island			X	Final report has been approved recommending plan like IL.
South Carolina			X	Tuition guarantee, legislation pending.
South Dakota				No pending legislation
Tennessee	Enacted			Pending IRS ruling.
Texas				No pending legislation No studies being conducted.
Utah				No pending legislation Watching national legislation.
Vermont				Task Force Report recommends wait for national plan or consider VT Education Savings Bonds.
Virginia		X		Bill passed House and Senate, not yet signed by Governor.
Washington				House and Senate have passed proposals modelled after IL plan
West Virginia	Vetoed by Governor.			Plan to reintroduce legislation.
Wisconsin			X	
Wyoming	Enacted			Program is in operation; no IRS requirement.

THE MICHIGAN EDUCATION TRUST

Michigan's guaranteed tuition program, the Michigan Education Trust (MET), allows parents, grandparents, and others to make a one-time lump sum payment, or periodic, fixed payments to prepurchase and guarantee college tuition for a child when that child is ready to attend college. Tuition and mandatory fees will be guaranteed at any of Michigan's 15 public colleges or universities or 29 junior and community colleges. If a student decides to attend one of Michigan's independent institutions or an out-of-state school, funds equal to the average tuition cost at Michigan's public colleges can be transferred to the school of the student's choice. Refund options are also available in case a child does not attend college. By providing such a guarantee, the Trust assumes the risk that the funds will be invested wisely and will grow as rapidly as tuition.

The MET will pool the payments received from purchasers, invest them and use the payments and interest earnings to pay the tuition costs for students at their respective colleges. Therefore, MET assumes the risks that the earnings will be enough to cover tuition costs and parents have the peace of mind that their children's college tuition is paid for.

There are many advantages to the Michigan Education Trust program. First, the state can pool the funds with other state funds, investing a much larger sum than an average family is able to, and gaining a much greater return on investment as a result. Second, the state can actually guarantee tuition, mainly because of its role in higher education policy and financing. Third, MET offers a choice of institutions to students and they do not have to select a college or university until they are actually ready to attend.

The Michigan Education Trust was signed into law by Governor Blanchard on December 23, 1986. The law specifies that before the program can be implemented, the Internal Revenue Service must provide a favorable ruling on the tax implications of the Trust's earnings for purchasers. The ruling request was submitted in February, 1987.

Purchasers of guaranteed tuition will be able to deduct their contribution from their Michigan income tax. Other tax benefits are anticipated, pending the IRS ruling.

Interest in the program has been tremendous. Over 33,000 inquiries have been received by telephone and mail. Currently, only Michigan residents are eligible for the program, however, it is hopeful that in the future reciprocal agreements can be arranged with other states and the program could operate nationwide.

Michigan is the first state in the nation to propose and enact such a program. It has generated a tremendous amount of interest nationwide, with five other states (Wyoming, Indiana, Tennessee, Florida and Maine) enacting tuition guarantee programs and approximately 35 other states considering adopting similar programs. Illinois and North Carolina have enacted education savings bond programs.

March 12, 1988

CHRONOLOGICAL HISTORY OF TUITION GUARANTEE PROGRAMS

June 1981	Eugene Lang announced his "I Have a Dream Program" in Harlem
January 29, 1986	Governor Blanchard announced tuition guarantee program in his State of the State Message
April 15, 1986	MET legislation introduced
May 27, 1986	Michigan House of Representatives passed legislation
December 9, 1986	Michigan Senate passed legislation
DECEMBER 23, 1986	Governor Blanchard signed program into law
February 19, 1987	Michigan Revenue Ruling request submitted to IRS
February 19, 1987	WYOMING's "Advance Payment of Higher Education" signed into law
April/May 1987	INDIANA's "Indiana BEST Program" signed into law
May 4, 1987	TENNESSEE's "Tennessee Baccalaureate Education System Trust Act" signed into law
June 1987	FLORIDA's "Florida Prepaid Postsecondary Education Expense Program" signed into law
June 30, 1987	MAINE's "Student Educational Enhancement Deposit (SEED) Plan" signed into law
July 21, 1987	NORTH CAROLINA's Bond Program signed into law
September 24, 1987	ILLINOIS's "Illinois Baccalaureate Savings Act" signed into law
January 1988	MASSACHUSETTS's "College Opportunity Fund" has been proposed by Governor Dukakis and legislation will be introduced for enactment this year
March 1988	MET receives IRS ruling

STATEMENT OF
O. DONALDSON CHAPOTON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to discuss tax incentives for higher education, including the Administration's proposal for College Savings Bonds. Education is a national priority deserving broad public and private support. In an increasingly complex society, education beyond the secondary level assumes greater importance for an individual's career opportunities and earnings as well as for the Nation's strength and competitiveness. College Savings Bonds would provide an important new tax incentive for families to save for their children's higher education.

In addition to discussing College Savings Bonds, I will discuss S. 39, which would restore the exclusion from income of employer-paid educational assistance; S. 628, which would allow a deduction for interest paid on student loans; and S. 2149, which would expand and make permanent the arbitrage rebate exception for certain student loan bonds.

Background

The Administration's Fiscal Year 1989 budget includes $11.5 billion of Federal assistance for higher education in the form of direct expenditures and special tax provisions. Of this amount, $9.2 billion is attributable to direct expenditures for higher education, primarily through student financial assistance and guaranteed student loan programs. Included in that total is an increase of $751 million in grants for students from low-income families to a total of $5 billion. The President's budget includes more Federal aid to low-income post-secondary students than has ever been available in the past.

The 1989 budget shows additional Federal assistance to post-secondary education in the form of special tax provisions totaling $2.3 billion. These tax provisions include the income exclusion for scholarships; the allowance of charitable deductions for contributions to colleges and universities; the tax exemption of interest on State and local student loan bonds and private non-profit educational facility bonds; and the dependency exemptions for students age 19 and over. In addition, the Federal government provides indirect support to nonprofit educational institutions by excluding interest, dividends, qualified rents and royalties from the unrelated business income tax.

The Administration's budget also proposes additional worker retraining opportunities. The Worker Readjustment Program proposal, financed at nearly $1 billion in 1989, would provide dislocated workers with essential services such as counseling, job search assistance, basic education, and job skill training. Direct Federal expenditures for training and employment programs will total $5.2 billion in 1989.

College Savings Bonds

The Administration's 1989 Budget includes an important new tax incentive, College Savings Bonds, that will help families save for their children's higher education.

Background

Providing for the costs of higher education has long been a traditional role of the student and his family. Unfortunately, the costs of a college education have been rising twice as fast as other prices in the economy over the last decade. Private education costs are up almost 90 percent since 1980 and public education costs have risen more than 70 percent during the same period. To put this in perspective, it now costs an average of more than $50,000 for a family to send a child to a four-year private university and more than $18,000 to send a child to a public university. The Education Department estimates that, nineteen years from now (in 2007), the total cost of attendance will increase to $200,000 for a private university and $60,000 for a public university.

Even though scholarship and loan programs are available, many families are not saving enough to meet these costs, especially for more expensive schools. A 1984 Roper Poll[1] showed that only half of the families who expect their children to attend college save anything at all for their children's future college education and that among the families that do save, the median saving is approximately $500 per year. As a result of the lack of planned saving, some students are limited in their choice of colleges. In addition, the lack of savings puts considerable pressure on family finances and raises the cost of Federal student aid. In many cases, students themselves incur large debts, thus taking on significant financial burdens for many years in the future. These problems are especially significant for students from moderate income families, since most financial aid programs assume that these families will pay a substantial portion of education costs.

The Administration believes that the primary responsibility for financing the costs of post-secondary education should remain a family priority. A Federal program to encourage saving for college education would not only call the attention of families to the need for saving, but would also provide a convenient mechanism and incentive for them to do so. We believe that College Savings Bonds would provide valuable and urgently needed assistance to American families in financing post-secondary education. There is a growing awareness of the need for such a program, as evidenced by the number of bills for Federal educational savings programs introduced in the 100th Congress.[2]

The Administration's Proposal

The Administration's College Savings Bond proposal would promote long-term saving by families for the costs of post-secondary education by encouraging families to save on a tax-free basis for their children's future education. Under the proposal, interest on College Savings Bonds would not be taxed currently and would be exempt from taxation when received if the bond proceeds are used to pay for the costs of a post-secondary education. If the bond proceeds are not used for this purpose, the deferred interest would be taxable upon redemption.

The types of educational costs qualifying for the tax exemption include tuition, books, appropriate room and board charges, and other fees associated with part-time as well as full-time attendance at eligible institutions that meet the standards for participation in the Education Department's student aid programs.

In order to target the program to low and moderate income families, the exemption from tax on interest income would phase out at annual levels of gross income between $60,000 and $80,000, adjusted for inflation after 1989. Thus, taxpayers whose adjusted gross income exceed $80,000 (adjusted for inflation) at the time the bonds are redeemed would not benefit from the exclusion. The income phase-out would be determined by the parents' income if the student has been claimed as a dependent by the parents in any of the three previous years; otherwise the income phase-out would be determined by the student's income. Thus, if a grandparent buys a bond in the name of a grandchild, the income phase-out would be based on either the child's or the parents' income.

Discussion

The benefits of College Savings Bonds can be illustrated by the following example. If a parent of a two-year old child purchases $2,000 in bonds in 1988 and in each succeeding year, the total accumulated funds would exceed $60,000 by the time the child is 18 (assuming an interest rate of 7.2 percent). This would be enough to pay the expected future costs of sending the child to a public university for four years. The tax savings for a family in the 15 percent bracket would be $6,800, or 11 percent of the total cost.

Based on the Education Department's estimate of participation, sales of College Savings Bonds would initially be $4-5 billion annually. The net cost of the program would be $10 million in 1989, rising to $200 million in the fifth year of the program. There would also be administrative costs depending on the method of implementing the program.

S. 39: Employee Educational Assistance Act of 1987

Background

Prior to 1988, up to $5,250 of the value of employer-provided educational assistance was excluded from an employee's income if the assistance met the requirements of section 127 of the Code. Section 127 limited the types of educational assistance that could be provided on a tax-free basis and required that the assistance be provided in a manner than did not discriminate in favor of officers, owners or highly compensated employees. In addition, under section 127, no more than five percent of the amounts paid under a qualified educational assistance program could be for the benefit of five percent owners.

Prior to the enactment of section 127, an employer's payment or reimbursement of an employee's educational expenses was included in the employee's income only if such expenses were deductible under section 162 as job-related expenses. If the employer paid or reimbursed the employee for educational expenses that were not job-related, the employee was required to include such amounts in income and no offsetting deduction was available.

Job-related education is generally defined as education that (1) maintains or improves skills required in the individual's employment or (2) meets the employer's express conditions as to the individual retention of job, job status, or rate of compensation. Education that qualifies the individual for a new job is not considered job-related.

Since the expiration of section 127 as of January 1, 1988, individuals may exclude from income only the value of employer-provided educational assistance that is job-related. The value of educational assistance that is not job-related is includible in income.

S.39

The Employee Educational Assistance Act of 1987, S. 39, would permanently reinstate section 127 of the Code, effective January 1, 1988.

Discussion

The Treasury Department opposes S. 39 for two primary reasons: first, section 127 creates an inequitable distinction between taxpayers, and second, it has not principally benefitted those most in need of assistance.

Section 127 provided tax-favored educational benefits to only a small segment of the population taking courses to train for a new job or occupation. The benefit of employee educational assistance plans was not available to workers whose employers did not offer such programs, or to unemployed workers. Moreover, self-employed individuals and many small business owners were, practically speaking, unable to benefit effectively from these programs.[3] As Table 1 indicates, eighty-four percent of adult education courses taken in 1984 to qualify for a new job or occupation were paid for by the student himself. Only sixteen percent of such training could have benefitted from section 127.

We believe that the tax treatment of non job-related educational expenses should be the same for all individuals. The operation of section 127 was inherently inequitable in that it provided favorable tax treatment to only a small, fairly select group of individuals. If educational training taken in order to qualify for a new job or occupation is deserving of government support, then all such training expenses should be deductible, not just those of certain employees.

Second, the available data suggest that section 127 did not principally benefit less educated or less skilled workers who would be most in need of further educational training. A Labor Department survey found that higher-paid professional and administrative employees were more likely than production workers to have employer educational assistance plans offered to them, and were more likely to be offered full, rather than partial, reimbursement.[4] Moreover, as Table 2 indicates, less educated workers in lower-paying jobs represented a smaller fraction of participants in adult education in 1984 than in 1969.

The total revenue cost of reinstating section 127, effective January 1, 1988, would be $275 million in Fiscal Year 1988 and approximately $400 million annually thereafter.

In summary, we believe that section 127 unfairly provided, at a substantial revenue cost, special treatment to only certain employed individuals who frequently were higher-paid professional and administrative personnel. For these reasons, we oppose the reenactment of section 127 in S. 39.

S. 628: Interest Deduction on Education Loans

Background

Section 163(h) of the Code disallows the deduction of personal interest. Personal interest is defined as any interest other than certain trade or business interest, investment interest, passive activity interest, qualified residence interest, and certain interest paid with respect to estate taxes. In general, interest on educational loans is personal interest. The denial of the deduction for personal interest is phased-in over the period 1987 through 1990.

S. 628

S. 628 would permit an itemized deduction for the full amount of interest on qualified educational loans, thus creating a new exception to the rule that disallows a deduction for personal interest.

Discussion

The Treasury Department opposes S. 628. As part of the Tax Reform Act of 1986, Congress explicitly considered the deductibility of all types of interest expense. In the case of business and investment activities, Congress decided that, with appropriate limitations, interest should be deductible. In the case of personal interest, Congress decided that interest should not be deductible. The Treasury Department does not believe this issue should be revisited at this time.

In addition, S. 628 is an inequitable approach to subsidizing educational costs. The bill would reduce the cost of education only to individuals who borrow and itemize deductions. Because individuals who itemize are generally wealthier than individuals who do not itemize, S. 628 would provide a disproportionate benefit for affluent taxpayers.

S. 2149: Arbitrage Exceptions for Student Loan Bonds

Background

Section 148(f) of the Internal Revenue Code requires issuers of State and local bonds to rebate to the United States arbitrage profits earned from investing gross proceeds of an issue of tax-exempt bonds in investments that are not acquired to carry out the government purpose of the tax-exempt bond issue. One of the principal objectives of section 148(f) is to eliminate so-called "collapsible" escrow bond issues in which the bond proceeds are invested in a higher-yielding escrow before being used for a governmental purpose. In these transactions, the arbitrage profits earned during the escrow period are sufficient to ensure the availability of sufficient funds, after payment of all bond issuance expenses, to "collapse" the issue by retiring all the bonds if the proceeds are not used for a governmental purpose. This collapsible structure facilitated the issuance of bonds for projects for which financing might never actually be needed or used.

Section 148(f) of the Code generally eliminated these collapsible bond issues by requiring issuers to rebate arbitrage profits earned during the escrow period. However, section 148(f)(4)(D) contains an exception to this rule which applies only to bonds issued on or before December 31, 1988, to finance Federally guaranteed student loans (GSL bonds). Under this exception, issuers of GSL bonds can use arbitrage earned during the escrow period to pay bond issuance costs, even if no student loans are financed. Moreover, issuers of GSL bonds can use arbitrage earned during the escrow period to pay program costs.

Section 148(a) of the Code provides generally that a bond is an arbitrage bond if the proceeds are used to acquire higher yielding investments. Section 148(c), however, provides that a bond is not treated as an arbitrage bond solely because the proceeds are invested for a reasonable temporary period until needed for a governmental purpose. The temporary period for proceeds to be used to make or finance loans generally may not exceed six months. Under section 103(c)(2)(B), however, this six-month period is extended to eighteen months for GSL bonds issued on or before December 31, 1988.

Under present law, qualified scholarship funding corporations are authorized to issue tax-exempt GSL bonds. Qualified scholarship funding corporations are not authorized to issue tax-exempt bonds to finance student loans that are not Federally guaranteed (supplemental student loan bonds).

S. 2149

Senate bill 2149 would make permanent the temporary arbitrage exception for GSL bonds and expand these exceptions to cover supplemental student loan bonds. The bill also would authorize qualified scholarship funding corporations to issue supplemental student loan bonds.

Discussion

The Treasury Department strongly opposes S. 2149. The stated reason for the temporary arbitrage exceptions was to permit issuers of GSL bonds to continue to issue bonds while they find other sources of revenue to defray bond issuance and program costs. H.R. Rep. No. 841, 99th Cong., 2d Sess. II-753 (Conference Committee). For the following reasons, these arbitrage exceptions are not warranted and should not be extended or expanded to cover supplemental student loan bonds.

First, issuers of GSL bonds are permitted under Treasury regulations to recover all of their bond issuance and program costs from the student borrowers by receiving higher interest payments on the student loan notes than the issuer pay on the bonds.[5] The temporary rebate exception, therefore, permits recovery of the same costs twice, once from the temporary investment arbitrage and again from the student borrowers. Moreover, if the bond proceeds are not used to finance student loans and are used solely to earn arbitrage, the issuers can still recover their bond issuance costs from the arbitrage. Thus, the temporary rebate exception permits risk-free, collapsible escrow bonds to be issued.

Second, there is no basis for treating these private activity bonds more favorably than bonds issued for essential government purposes. GSL bonds are not distinguishable from other bonds to which the arbitrage rebate rules fully apply. Moreover, the special rebate exception is not necessary for the issuance of GSL bonds. The risk that bond issuance costs will have to be paid out of other available funds if the bond proceeds are not used to finance student loans can be eliminated by delaying issuance until the bond proceeds are actually needed to finance the student loans. To the extent the bonds are issued earlier than necessary, the early issuance risk should be borne by the issuers--not by the Federal government.

Third, many issuers of GSL bonds have accumulated large surpluses over the years from issuing GSL bonds and investing the bond proceeds in higher yielding investments and student loan notes. A special exception that permits these issuers to use temporary investment arbitrage to issue bonds at no risk, and to recover the same costs twice, is not defensible as a matter of tax policy.

Finally, student loans financed by supplemental student loan bonds are not subject to Federal income limits applicable to Federally guaranteed student loans. These bonds do not fulfill Federal policy goals of aiding lower income families, and thus the authority to issue them should not be expanded.

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This concludes my remarks. I will be happy to answer any questions.

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[1] "A National Study on Parental Savings for Children's Higher Education Expenses," conducted for the National Institute of Independent Colleges and Universities by the Roper Organization, August 1984.

[2] A number of bills introduced in the 100th Congress would provide tax incentives to save for higher education by creating either Education Savings Bonds (S. 1662 and S. 1817), Education Savings Accounts (S. 1533, S. 1659, S. 1660 and S. 1661), or Education Savings Trusts (S. 1572). These bills would provide either deferral of, or exclusion from, tax with respect to income which is used to finance qualified educational expenditures.

[3] Although section 127 provided that self-employed individuals and sole proprietors could technically qualify for the benefits of section 127, in practice these benefits were primarily available to only larger businesses. Small, closely held businesses were unable to benefit from section 127 because no more than five percent of the amounts paid under the educational assistance program could be for the benefit of shareholders or owners owning more than five percent of the capital or profits interest in the employer.

[4] U.S. Department of Labor, Bureau of Labor Statistics, 1986, Employee Benefits in Medium and Large Firms, Washington: U.S. Government Printing Office.

[5] A pending technical correction would clarify that amounts designated as interest on student loan notes were not intended to be treated as a reimbursement of costs for purposes of the rebate exception.

Table 1

Adult Education in 1984
Reason for Taking Course and Source of Payment
(in thousands)

	Total Courses	Job-Related Courses			Non-job-Related Courses	Unknown
		Improve in Current Job	New Job in Same Occupation	New Job in New Occupation		
Total Courses	39,097	19,703	984	3,818	14,448	145
Employer Paid	14,003	12,328	242	549	857	28
Employer Paid as a Part of Total Course	36.3	62.6	24.6	14.4	5.9	19.3

Source: Tabulated from: U.S. Department of Education, Center for Educational Statistics, Trends in Adult Education 1969-1984, Tables G-H, pp. 33-36.

Table 2

Distribution of Adult Education Participants and the Adult Population 17 Years and Older, by Selected Characteristics May 1969 and 1984

Characteristic	Adult participants		Population 17 years old and over	
	1969	1984	1969	1984
Total number (in thousands)	13,041	23,303	130,251	172,583
Total percent	100%	100%	100%	100%
Education level:				
Less than 12th grade	16	8	44	27
High school graduates	39	30	34	38
Some college (1 to 3 years)	20	26	12	18
Bachelor's degree or higher	26	36	10	17
Income group:				
Above median family income	68	65	50	50
Below median family income	32	35	50	50
Occupational groups:*				
Executive/managerial	11	15	9	11
Professional/technical	33	31	13	15
Administrative support	17	17	15	16
Sales and service	16	20	27	26
Other	23	17	36	32

* The basis of these percents are employed adult education participants and the employed population 17 years and older.

- Not available.

Note: Details may not add to totals because of rounding.

Source: U.S. Department of Education, Center for Educational Statistics, Trends in Adult Education 1969-1984, Table 1, page 3, 1987

PATRICIA A. HAYES, PRESIDENT
SAINT EDWARD'S UNIVERSITY

Mr. Chairman and Members of the Committee:

I am Patricia A. Hayes, president of Saint Edward's University in Austin, Texas. Saint Edward's University is a private, Catholic affiliated university enrolling 2700 students; 1300 of whom are part-time undergraduate and graduate students, and 1400 of whom are full-time undergraduate students. Saint Edward's provides virtually all of the baccalaureate and master's level part-time adult education in the Austin area. For 15 years, Saint Edward's has played a unique role in educating the children of migrant farm workers.

For the past two and one-half years, I have been the chair of the Tax Policy Subcommittee of the National Association of Independent Colleges and Universities (NAICU), an organization representing more than 800 independent colleges and universities. I am here today on behalf of NAICU to bring you our concerns about the need to develop meaningful national tax policy toward college and university students. I commend the leadership shown by this Committee in holding hearings on these important topics of education savings, employee educational assistance, deductibility of interest on education loans, and taxation of scholarships and fellowships.

Tax Incentives for Savings for Higher Education

NAICU is committed to working with Congress to create an efficient and cost-effective form of tax incentives for education savings. The absence of such a program presently represents a gap in federal policies in support of higher education. There are two central concerns which drive our interest.

The first of these concerns is the lack of saving among those who can afford to be saving. In 1986, American households saved only 3.9 percent of their disposable income -- the worst year for personal saving since World War II, and down from a post-war peak of 9.4 percent in 1973. The comparable personal saving rate for Japan was more than 17 percent in 1985.

And, second is the marked shift in trends of financing higher education. Over the past ten years, student financial assistance has shifted dramatically from a reliance on grants to a reliance on loans. Presently, loans account for about half of all aid available (up from 16 percent in 1975-76), with grants diminishing from 80 percent to 47 percent over the same period. Sources of aid also have changed substantially. During the time when the value of federally supported student aid was falling between 1980-81 and 1986-87 by 16 percent in constant dollars, institutions of higher education, particularly independent colleges and universities, increased their own aid by 41 percent in constant dollars. At many independent colleges and universities, diverting more resources to student aid -- in some cases as much as 40 percent of their total budget -- has meant a heavy burden on the institution's resources.

As a result, students and their families pay a greater share of the cost of attending independent colleges and universities. Among student aid recipients, contributions from family resources rose from53.0 percent of the total price charged in 1979-80 to 65.5 percent in 1983-84. This rate of increase outpaced the rate of inflation by 51 percent.

There is evidence that families recognize the importance of saving for college but need help to do so. In 1984, the National Institute of Independent Colleges and Universities (NIICU) contracted with The Roper Organization to poll families on attitudes toward savings for their children's higher education expenses. The study revealed that 77 percent of parents with children of pre-college age expect, or at least hope for, their children to go to college. Parents see themselves first (66 percent) and their children second (36 percent) as having primary responsibility for financing college. When asked whether they were currently saving for their children's college education, parents of prospective college entrants showed that only half are currently saving, that they saved an annual median of $517 in 1984, and that they started saving for college when their oldest child was four years old. The half who are not saving now say they cannot afford to, but 2 in 3 plan to save later. Future savers plan to start when their child is 12 years old, allowing six years of saving. Yet, these same parents plan to have -- or hope they may have -- $10,000 saved when their youngest child is ready to go to college.

With these patterns and needs in mind, individual colleges and states have attempted to devise limited strategies to spur savings. Approximately 12 independent institutions developed innovative contracts to prepay tuition before the child reached college age; several of these are no longer operational because they have not proven to be financially feasible for the institution. Numerous states have explored possibilities of state plans. These plans have a number of different characteristics, but common to each are limitations on where the students can use the funds saved. Private savings banks, such as those that market tuition-indexed certificates of deposits, have prompted responses from upper-income individuals, failing to reach those of more modest means.

Although states, individual colleges and universities, and financial institutions have led the way in developing innovative plans, these are piecemeal approaches and lack the consistency and accessibility that only a federal plan could provide. Furthermore, they do pose a threat to access and the opportunity for student choice that has characterized this nation's system of higher education.

Clearly, there are a number of national models and means of encouraging savings for higher education. In order for such a plan to work, to actually encourage new savings among families which are not currently saving, the following key elements need to be included:

First, the plan must be simple and inspire the confidence of the saver. In order to be effective, a federal education savings plan needs to be easily understood by families. It must also be easy to administer and rules regarding withdrawal of funds should be straightforward. The plan should utilize a system for savings that inspires confidence for those making a long-term investment.

Second, the plan should supplement, not supplant, existing student aid programs. A reasonable mix of loans, grants, and work should remain the cornerstone of federal student assistance policies and clearly cannot be replaced by education savings programs, no matter how effective. It is imperative that any education savings programs serve as a supplement to other sources of funds. The precise treatment of these savings under student assistance programs should be resolved separately by the Congress as a part of its consideration of needs analysis for student assistance.

Third, the plan should encourage student choice and ensure portability. Education savings are an important component in assuring access to the institution best suited to a student's needs, whether in-state or out-of-state, or whether it is state-supported or independent.

Fourth, the most important tax incentives are those which coincide with the payment of education expenses. The most significant and the least costly of the numerous tax incentive options is one provided at the time that education expenses are actually being paid, and which focus upon the core education costs -- tuition and fees.

Fifth, participation in an education savings plan should be broadly accessible. Relatives, friends, and employers should be eligible to make contributions. Incentives should be available to the broadest possible spectrum of families at each income level to encourage these crucial personal investments in education.

I would like to stress the point that saving, while important, is just one element of the partnership of sources of paying for college and cannot be viewed as a panacea for the problems in meeting college tuitions. However, saving is an undeveloped avenue for helping to finance higher education and deserves focused attention and incentives to realize its potential.

I would also like to note that the use and level of saving rises as income increases. Most savings plans are, therefore, more likely to be used by middle- and upper-income families which makes it all the more necessary that a national, education savings plan be designed to attract the widest number of participants, and that federal student assistance programs be expanded to meet the needs of students whose families are unable to save under any condition.

Of the various education savings options, plans such as the one outlined in S. 1817 come closest to meeting the features which I have listed. This option provides an easy-to-understand and convenient method to save, an instrument, U.S. Savings Bonds, that is already known by most people and that is accessible by most family income levels, and permits use at all colleges and universities. Perhaps of greatest interest to all of us who are preoccupied with reducing the federal deficit, this plan actually draws funds into the U.S. Treasury and costs little in tax expenditures. We urge you to look carefully at this straightforward option.

Extension of the Employee Educational Assistance Act

Section 127 of the Internal Revenue Code, the Employee Educational Assistance Act, expired for the third time in its history on December 31, 1987. NAICU strongly supports S. 39, which would make this provision a permanent part of the tax code, and would urge that it be promptly enacted by the Senate.

The Employee Educational Assistance Act allowed employees to receive, as a tax-free fringe benefit, tuition support to pursue higher education. This section has enabled many low-paid and under-educated workers to return to school part-time, and to earn a degree that qualified them for better and higher paying jobs. This section also allows graduate teaching and research assistants to receive tuition remission in support of their education tax free.

Since the expiration of Section 127, these same benefits now become taxable to the students. Clearly, many of the students for whom this section was envisioned will not be able to continue their education if they must pay taxes on the value of tuition from their own limited wages. Even more unfortunately, without Section 127, the only tax-free employer-provided education dollars are those that are related to the current job. This, in essence, benefits those of us who have already completed our education and are merely "keeping up" with new developments, but provides no benefits to those who want to improve their job skills and advance their professional opportunities.

The repeated extension and expiration of this provision have operated to undermine the goals of the provision. This section should be made a permanent part of the tax code.

Deductibility of Interest on Education Loans

The Tax Reform Act, enacted into law on October 22, 1986, phases out and eventually eliminates the deduction allowed to itemizers for the interest paid on education loans. This change incorrectly treats this indebtedness as merely another form of consumer interest instead of investment interest, thereby increasing the costs of education debt for the many Americans who borrow as an investment in their own future.

Clearly, loans are an increasingly significant part of financing higher education. Based on the most recent figures available, approximately $76.9 billion in loans to finance higher education are presently outstanding; $9.3 billion in new federally guaranteed loans were made as part of the 1987 fiscal year.

We urge Congress to adopt S. 628 to allow interest on education loans to be deductible in the same manner as is presently allowed for interest on business investments.

Taxation of Scholarships and Fellowships

The Tax Reform Act of 1986 also rewrote Section 117 of the Internal Revenue Code pertaining to the taxation of scholarships and fellowship awards. The new Section 117 subjects to taxation the portion of any scholarship or fellowship that is granted to cover non-tuition educational expenses, such as room, board, and necessary travel. The law also requires that any payments for which a service requirement exists will be treated as taxable income, thus converting many graduate student tuition grants and teaching and research fellowships into taxable wages. These are among the most unfortunate of the tax reform revisions.

Although former Section 117 was unduly complicated, prompting audits and conflict between students and the Internal Revenue Service, the present system is not an improvement. The Act converted academic awards into a morass of taxable and nontaxable awards, portions of which are subject to withholding, other portions of which are subject to the payment of estimated taxes by students, and part of which are tax free. Students must now retain book lists and receipts, match academic year grants with the tax cycle, and calculate taxable wages, taxable scholarships, and tax-free gifts from the same awards just to determine if any taxes are owed. All of this compels scholarship recipients of aid above tuition to file a 1040 Form which, in turn, precludes them from using a simplified needs-analysis form to receive student aid.

We urge the Finance Committee to address these issues promptly, and to adopt a simple tax provision consistent with the purposes and nature of student aid.

Thank you, Mr. Chairman and members of the Committee, for holding these hearings on these important topics.

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Michael S. McPherson
Chair, Economics Department
Williams College

Thank you for the opportunity to offer testimony on this important subject.

You are considering a number of bills that would provide a tax preference for families who save for college. These bills share two worthy goals: encouraging Americans to save more, and encouraging American parents to plan and provide more effectively for their children's college education. Traditionally, Americans have believed that the first responsibility for paying for college lies with the parents. Increasingly, we have come to recognize that many families can best meet those responsibilities by spreading the high cost of college over time: paying for college, like paying for a house, is tending increasingly to become a lifetime proposition. While some of that cost spreading can be -- and indeed is -- accomplished through parent or student borrowing, many observers agree that a healthy system of college finance would include more advance planning and saving for college than most families presently achieve. We thus find ourselves searching for ways in which the federal government can, at reasonable cost, help encourage such advance preparation.

The bills before this committee pursue this worthy goal through the device of tax incentives. This is a feature that I, and I suspect many economists, are less happy about. The reduction in tax preferences accomplished by the tax reform legislation passed in 1986 was, in my view, a landmark achievement. Tax preferences are often poorly targeted on their goals, they tend to benefit the well off disproportionately, and they often prove extremely difficult to dislodge once they are in place. I am pleased that this body is examining with great care proposals to introduce new preferences to the tax code.

A desirable scheme of federal encouragement for college saving would, in my view, have these features:

It would maximally encourage additional saving, rather than providing federal subsidy for saving that would have taken place anyway.

-it would target federal help on those who would find it difficult to save without such support;

-it would minimize the creation of new federal institutions and bureaucracies; and

-it would encourage families of modest means to begin planning early and effectively for their children's educational future.

Let me first make the point that an excellent means of accomplishing several of these goals would be through an improved and expanded version of the Pell grant program. This program works through federal bureaucracy that already exists and it is targeted effectively on needy families. A secure and reliably funded program of basic grants is a fine encouragement to the educational aspirations of young people.

If needy families see a stable basis for college finance, this may be an encouragement to them to plan early. Against this it can be argued that the availability of grant aid blunts the incentive to save. I examined this issue with a colleague, Chip Case of Wellesley College.[1] We concluded that the Pell program probably did not introduce significant savings disincentives, although grants provided by institutions to more affluent students may have such effects. Two reforms -- in addition to more reliable and generous funding -- might make the Pell program more effective in encouraging families to plan and provide for college. First, we need better screening of the educational effectiveness of schools that are eligible to receive grants, to help ensure that families' investment of their own resources in schooling are worthwhile. Second, it would be desirable redesign the Pell award rules so as to provide larger Pell grants to families that contribute more to their children's education out of any given ability to pay.

If I had to choose between the alternatives of putting federal resources into tax preferences for college saving and of funding the existing grant programs more generously, I would certainly opt for the latter. Notice also that new programs to subsidize college saving could take the form of direct federal matching expenditures rather than tax benefits. Nonetheless, it seems clear to me that some of the tax preference bills before you are considerably more attractive than others, and I will turn now to that comparison.

First, a preliminary point. It is not clear to me in every case who is the presumptive taxpayer in these bills. If, say, a parent purchases U. S. savings bonds and devotes them to her child's education, does the legislation suppose that it is the parent or the child who pays the tax? Do income ceilings on tax benefits apply to the parent's or the child's income? I assume that it is the intent of the drafters that these policies have reference to the parent's (or other contributors') income and taxes unless clearly stated otherwise, and I will proceed on that assumption.

The bills differ on several important dimensions.

1. Income limitation

Two bills (S1572 and S1817) limit tax benefits according to family income. The others do not.

Programs that restrict tax benefits according to family income have a much better chance of being reasonably effective in encouraging new saving and in targeting tax benefits on families that have difficulty saving. Families of substantial means can readily reallocate their portfolios to take advantage of tax subsidies without changing their saving behavior or the college destinations of their children one iota. Including such families is wasteful and unfair. Because use of tax preferred investment instruments is much more frequent among the affluent, the absence of income limitations can be expected to add substantially to the cost of a proposed program.

It is a matter of judgment where an income cutoff should come. I prefer the $100,000 cutoff in S. 1572 to the $150,000 cutoff in S. 1817.

2. Degree of tax preference

The proposals differ substantially in the generosity of the tax preferences they offer to savers. Bills S1533 and S1572 would provide both a deduction for initial contributions and tax free use of the proceeds of these accounts for educational purposes. This treatment is quite substantially more generous, for example, than that provided to IRA's before the recent tax reform. Not only is the income generated by these accounts never taxed, but under these arrangements the principal is never taxed either. In work with Charles Byce of the Brookings Institution, we estimated that the tax cost of this form of exemption is three or four times as great as the cost of deferring tax on contributions and income until the time of withdrawal.[2]

Several other of the bills (S1659, S1660, and S1661) provide tax advantages both at time of contribution and at time of distribution, but recover some of the funds by taxing either income from the accounts or the earnings of account beneficiaries. The least expensive of the bills are the two that simply forgive tax on interest earned by savings bonds (S1667 and S1817).

How much preference this use of savings deserves is a matter of political and social judgment. It is clear that the more generous programs, if they prove popular, would cost substantial tax revenue; the loss would be most severe from programs that combine generous treatment with the absence of an income limitation on the tax benefits. The need to weigh these uses of funds against the alternative of maintaining or expanding existing student aid programs becomes especially urgent in this case.

3 Institutional requirements

The bills differ markedly in the amount of regulation, reporting, and bureaucratic management they require. The simplest is S1817, which requires only certification of the educational use of bond proceeds. S1572, with its proposed new federal entity, the National Education Savings Trust, may be the most complex. Other bills require the creation and management of new specialized accounts in banks. Several would also require reporting of income from account distributions over a ten year period - a substantial reporting burden.

The principal reasons I can see for setting up separate accounts for educational saving are (1) to permit an immediate tax advantage for contributing to such an account, rather than providing benefits only when such accounts are distributed, and (2) to make it possible to penalize the non-educational use of funds that had been contributed to specialized accounts. The issue, then, is whether plans that provide tax benefits for educational use at the time of distribution provide adequate incentive both to save and to put the savings to educational use. This is partly a question of how large a preference Congress wants to create. As I have noted above, the degree of tax preference provided by some of these bills which provide both immediate and later tax benefits is quite large. Simply excluding interest on savings devoted to educational purposes from taxable income -- which can be done readily without creating new financial instruments or institutions -- does provide a significant tax benefit.

My own view is that any program of tax preference enacted by Congress should be kept modest in cost, simple in operation, understandable to the public, and limited to families of modest means. S1817, sponsored by Senators Kennedy and Pell, comes closest to meeting these criteria. Several of the other bills could be improved by imposing income limitations on benefits to contributors, by reducing the degree of tax preference they offer, and/or by simplifying their reporting and regulatory requirements.

I would like to conclude with brief comments on two matters related to this committee's concerns. First is a comment on state activity regarding encouragement to college saving. A number of states are in the midst of designing plans to encourage either saving for college or "prepayment" of college tuition. Much energy has gone into efforts to design these plans so as to gain a ruling from the U. S. Internal Revenue Service that income earned within these plans is not taxable. This seems to me a perfectly awful way for states to make policy. It's especially troubling that, under current law, a plan is more likely to gain favorable tax treatment the more severely it constrains students' educational choices (because that makes it look more like an "advance purchase" and less like an investment). It seems to me highly desirable for Congress to determine what -- if any -- state (or private) plans for prepayment of college tuition deserve favorable federal tax treatment, and to legislate accordingly. I'm doubtful that any plans deserve such assistance, but the most obvious criteria to impose would include fiscal soundness of the plan, minimal interference with family choice of educational institution, and limited penalties for withdrawal from the plan.

Finally, I would like to underline the importance of helping families learn to plan for college investments. College education, especially at a selective private institution, _is_ expensive, but I believe that part of the current high level of anxiety about paying for college results from the fact that we haven't helped families learn to view college as a long term investment. Families often start thinking about college - both academic and financial preparation very late - and often don't understand fully how financial aid, credit arrangements, and (if they start early) savings plans can help them manage. At least as important as having the federal government provide financial incentives to encourage saving for college is the educational task of helping families learn to think about these issues in a longer time perspective. This is a task in which educators, community leaders, and government officials at all levels can share.

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[1] Karl Case and Michael McPherson, "Does Student Aid Discourage Saving for College?" Washington, D.C.: The College Board, 1985.

[2] Michael McPherson and Charles Byce, "IRA's for College Saving", paper prepared for the annual meeting of the National Association of Independent Colleges and Universities, Washington, D.C., 1985.

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Judith Eaton
President, Community College of Philadelphia
Chair, American Council on Education

Mr. Chairman, I am pleased to have this opportunity to testify before the Senate Finance Committee, and to urge the restoration of one of the strongest planks of U.S. economic competitiveness, the employee educational assistance provided by tax code section 127, by which training costs paid by employers to help employees improve job skills were not taxed as employee income.

My name is Judith Eaton. I am President of the Community College of Philadelphia, Chair of the Board of the American Council on Education, and past Chair of the Board of the American Association of Community and Junior and Community Colleges. I am testifying on behalf of the more than 200 organizations that form the Coalition for Employee Educational Assistance, who share the conviction that employee educational assistance has been building the skill base the U.S. economy must have to regain its once-cherished lead in global productivity.

Today, we urge the Committee to report favorably Senator Daniel P. Moynihan's bill, S. 39, which would restore permanently the Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987.

Section 127 has been part of the Internal Revenue Code since 1978 (PL 95-600). It was enacted to eliminate the confusion created by a prior Treasury regulation (162-5), which required employees to demonstrate that the educational assistance provided to them by employers was strictly job-related. Otherwise the benefits would be considered taxable income.

This regulation, in effect, discriminated against lower-level employees, who had more narrowly defined job descriptions. Top personnel could justify almost any course -- English, psychology, computers, etc. -- as related to their performance as managers. However, clerical and production workers were sharply limited in the type of courses they could take and still not have their tuition assistance taxed as income. The obvious irony was that the lower-level employees could less afford taxes on employer-paid tuition assistance than could management personnel.

Fortunately, Congress acted in 1978 to eliminate the iniquities of regulation 162-5. Over the past nine years, more than seven million workers have used Section 127 assistance to upgrade their skills and to keep themselves competitive on technological and industrial developments. In addition, Section 127 has created incentives for upward mobility within the workforce.

In preparation for Congressional testimony during the massive tax reform efforts of the 99th Congress, the American Society for Training and Development, conducted a 1985 survey on employee educational assistance -- who pays, who benefits. The survey sample selected was 1,000 public and private employers with a range of 43 to more than 100,000 employees. From the 319 employers responded who responded, the survey revealed some very useful facts:

**97% of all respondents have educational assistance plans;

**91% of the respondents cited their local community college as a provider of educational assistance courses;

**96% of respondents said educational assistance was used for improving skills and performance on-the-job;

**54.8% of respondents said educational assistance helps employees learn basic skills like reading and writing;

**and most significant, 72% of employees taking education and training courses earn less than $30,000 a year.

I might point out that as the largest branch of higher education, community colleges provide a variety of low cost, high-quality postsecondary education and training opportunities in close proximity to the homes and/or jobs of at least 90 percent of the Nation's workforce. Community colleges also excel in partnershipping arrangements that deliver specialized training programs meeting specific employer needs.

At my own institution, the Community College of Philadelphia, we have contracts with more than two dozen major employers, public and private, serving the job skills needs of some 5,000 employees. Members of the local Health Workers Union train under one such contract. This total does not include the untold numbers of working adults who enroll in our courses with individual assistance from their employers. Nor does it cover our training for the U.S. Navy Yard, amounting to an annual full-time equivalent (FTE) of some 400 students. Nor does it cover the work the College is doing with the local Service Delivery

Area under the Job Training Partnership Act; nor the customized retraining we perform for key industries under Pennsylvania's economic development program. Comprehensive as they may sound, CCP's partnerships with employers are only typical of what employers and community colleges across the Nation are doing together to meet the skill demands of the global economy.

Mr. Chairman, Section 127 is a critical tax incentive that promotes training and retraining in the workplace. Much of this training could be lost if Congress fails to act to restore this provision.

The expiration of Section 127 could also have a potentially devastating impact on graduate work and the Nation's supply of scientists and engineers. In order to encourage scholarly achievement, colleges and universities have traditionally offered outstanding graduate students a package of financial assistance. Such assistance generally includes both cash stipends for time spent in teaching or research, and tuition waivers or reductions. Federal law until last year allowed graduate assistants to exclude the value of tuition reductions from their income. The Tax Reform Act of 1986, however, restricted the exclusion. The Act requires students to pay tax on all amounts granted as compensation for services, whether paid in kind or in cash. Since many institutions couple cash awards with tuition reductions, there is now widespread uncertainty whether such reductions are excludable when awarded to graduate assistants who perform services.

Since the passage of the Tax Reform Act, many colleges and universities, particularly those which offer closely coupled stipend-waiver arrangements, have relied on Section 127 to make tuition reductions excludable. Section 127 has also provided relief to those institutions which are required to characterize tuition reductions as compensatory for state or federal (non-tax) law purposes. If Section 127 is not restored, many graduate students will be required to pay tax on their tuition reductions, thus increasing the cost and the difficulty of financing long courses of graduate study.

The recent expiration of the EEA already is creating a hardship for many graduate students. For example, out-of-state teaching assistants at the University of Michigan returned for the winter term to find that the new withholding requirements took an average of $736 per term (28%) from four months of salary. This represented a $184 per month cut from a previous take-home salary of $652 per month; $468 per month was left for a married student with one dependent.

Graduate assistants are selected to teach and conduct research because of their scholarly potential. Many in their number will be future college faculty members, and many will become leaders of science, business and government. Regrettably, without Section 127, the tax code would become a disincentive for graduate study.

The importance of Section 127 to the Nation's skill base and revenue base is graphically portrayed by individual careers. Consider Joseph Ortega, a Lakewood, CO, nurse. He started his career 28 years ago as an unskilled hospital orderly. With stipends from the St. Anthony's hospital system in Denver, he earned his licensed practical nurse (LPN) certificate. That step alone doubled his earnings. Later, as an employee of Dow Chemical, and with Dow's help, he completed an associate degree at Front Range Community College, which enabled him to obtain registered nurse (RN) licensure. Remarkably, that again doubled his earning power. More recently, again with employer assistance, he completed his bachelor's degree at Denver's Metropolitan State University, while continuing his full-time nursing career. The BS added another $2 an hour to his pay. Without the employer assistance, he might still be an unskilled orderly, or a victim of unemployment. The modest federal revenue foregone to cover Mr. Ortega's employee educational assistance has been repaid many times over in added taxes flowing from his increased earnings.

Employee educational assistance has been boosting hundreds of thousands of individual careers, and their earning power, this way every year. Such career gains enhance both the income tax base and Social Security revenue. It seems highly probable to us that any immediate sacrifice in federal revenue tied to employee educational assistance is repaid at least twenty-fold in later career earnings. Research has shown that completion of a two-year or four-year college degree extends the career life of the typical American by four to five years, not to mention salary and revenue increases that attend such skill gains.

The economic activity that perishes with the demise of Section 127 also should not be overlooked. The whole training enterprise associated with it -- the job and sales activity involved -- might alone account for enough taxes to cover the revenue foregone.

The Labor Department study, Workforce 2000, shows that the typical American entering the workforce now is likely to change careers five or more times, as our economy wrestles with the challenges of a new century. The risks those changes pose for both the workforce and the economy will be much greater if they come without the benefit of Section 127 benefits. The college population 22 years and older earning credit today is much larger than the so-called traditional 18-21 year-old enrollment. By 1984, the credit enrollment of part-time students was almost as large as the full-time credit population. For vast numbers of working mothers and single parents, who are increasingly essential to a globally competitive American skill base, career and skill gains will be possible only when employee educational assistance is available.

Education, training and retraining of Americans already employed will become even more critical as the economy enters the 1990s, because the country faces a period in which the year-by-year workforce growth rate will barely match that of the Great Depression. Industry, the military and higher education will be competing for the markedly diminished supply of high school graduates. It will be imperative to our economic competitive strength that older workers gain skills that will keep them in the workforce. Employee Educational Assistance offers the only proven strategy for meeting this need.

In conclusion, Mr. Chairman, we offer the Committee two thoughts from last week's celebration of the Labor Department's diamond jubilee. Morton Bahr, President of the Communication Workers of America (CWA), said tomorrow's "job security rests on retraining, not on empty guarantees." And in the words of Harold A. Poling, Vice Chairman of the Board of Ford Motor Company, "The real competitive edge we must develop is the American workforce." We sincerely believe that this challenge cannot be met, will not be met, without permanent restoration of Section 127. Thank you again for this opportunity to address the Committee. I would also like to request that the list of current members of the Coalition for Employee Educational Assistance be included in the hearing record.

Testimony of

The Honorable Roger N. Begin

Good morning,

Senator Bentsen, members of the Senate Finance Committee, my name is Roger Begin. I am the General Treasurer of the state of Rhode Island. I sincerely appreciate the opportunity to speak this morning before the Committee on a subject which I believe is very important to the future of this nation -- affordable higher education.

One of the most important functions of government is to provide educational opportunities for our people. Education is the foundation of all that we do. Without a well-educated work force, our dreams for a better future for our children and grandchildren and for America itself are in peril. Indeed, the intense competition we are experiencing from all quarters of the globe points out how vital it is for us to develop our most important resource -- the intelligence, imagination and creativity of our people.

We in New England learned long ago that our future was tied to our education system, particularly institutions of higher education. Less than a decade ago New England was in the midst of an economic downturn from which most experts predicted we would not emerge. Today, however, the economy of New England is stronger than ever. In fact we are in the enviable position of having an unemployment rate so low that in some industries there is a labor shortage. The economic resurgence we experienced during the past decade is directly attributable to the great concentration of institutions of higher education and the large number of college educated workers.

Recent national trends, however, contain some very ominous implications. College tuition increases have outstepped inflation and are expected to continue to do so.

Tuition costs at public institutions between 1980 and 1984 rose by 49% while family incomes rose by only 29%. Compounding that problem is a decline in federal assistance provided to students and their families along with a shift from grant programs to loan programs. Further compounding the problem is the fact that Americans as a whole just do not save much of their income.

We may now be approaching the point where the percentage of high school graduates able to go on to college will actually begin to decline. And those that are able to go on may find themselves heavily in debt. The implications of such a trend are truly alarming. Indeed, I believe we simply cannot allow that to happen.

The states have been aggressive in taking up this challenge. A fifty state survey conducted by the Education Commission of the States (ECS), showed that as of February 1988, six states had enacted tuition pre-payment programs and two states had enacted savings incentive programs. Proposals of various types were also being considered by thirty-six other states. The level of discussion differs significantly from state to state, but each plan utilizes one of three basic approaches: a guaranteed tuition plan pioneered in Michigan, a college bonds program first enacted in Illinois and a state income tax credit program for contributions to education savings accounts developed in Missouri. Additional programs are likely to be proposed given the important nature of this topic.

The federal government as well has begun to recognize the problem. Some twenty-five college savings bills have been introduced into the Congress including the National Education Savings Trust (NEST) program proposed by Rhode Island's own Senator Claiborne Pell, a distinguished member of the Senate and a nationally recognized leader in the area of higher education.

There are a number of policy issues relative to college savings programs which need to be considered when developing a specific program.

First, we must remove the disincentives for parents to save for their children's education. Presently, if you or I had the foresight to put aside some money each year for education, in most instances, the interest on those funds would be taxed at both the state and federal level. Further, those assets would be held against us when our children applied for financial aid. These policies discourage savings and lead to reduced educational opportunities along with contributing to increased student debt.

Second, it is my belief that any program must preserve freedom of choice. The prospective student should be able to attend any public or independent college whether in-state or out-of-state. Programs which construct barriers to free choice will balkanize higher education and in the long run, will not serve the public interest.

Third, we need to recognize that any solutions we propose must take into account that each family has only a limited amount of resources available for education. It is important that these resources be invested wisely. Federal and state programs should complement one another, not compete with each another. Programs must be flexible and adaptable to changing conditions.

One year ago, I requested that a special legislative study group review the entire area of higher education costs and make recommendations to me on how we in Rhode Island could deal with this growing problem. Last month the commission released its report. I have included a copy of that report along with my testimony to you today.

Two weeks ago I introduced these proposals as part of my 1988 legislative package. Quite simply we in Rhode Island propose to do four things:

First, in order to encourage people to save, we plan to issue college bonds -- small demonination tax exempt "zero coupon" type general obligation bonds of the state. These bonds will be offered to average income families. We hope that by making it attractive and easy to save, we can encourage parents to plan ahead. The success of the Illinois program indicates a great demand for this type of college savings program. The first $90 million in college bonds offered by Illinois this past January was oversubscribed by 300%!

Second, we propose to disregard the first $25,000 in Rhode Island College Bonds from the financial asset test when awarding state scholarship grants. This removes a disincentive for saving and it further enhances the attractiveness of the college bonds.

Third, we propose to double the funding of our state scholarship program over the next four years. Grants would be increased from $8.5 million per year today to $17 million per year by 1993. This action will help address the problem of declining federal assistance.

Finally, we are proposing that interest earned on special education savings accounts be exempt from state taxation. This would provide a further incentive to save and would give those parents who could not buy Rhode Island College bonds a chance to get the same state tax benefit as those who did purchase the bonds.

I believe our program provides realistic and sensible options for parents. While these proposals do not represent a complete solution to the problem of affordable higher education, they are clearly a good beginning.

But despite all this activity, the states alone cannot shoulder the entire burden. We need the support and cooperation of the federal government. We need to work together as partners to address this problem. Additional federal grants to students are a priority. We also need federal leadership to encourage savings for education costs by removing existing disincentives.

The commitment we make to higher education should not be looked on as an expense, but as an investment in America's future. An investment that will return greater dividends in the years to come. As we approach the 21st Century, let us remember that the future belongs to those who prepare for it. The Congress of the United States has an opportunity to help millions of young Americans prepare for the future by taking decisive action at the federal level to support higher education and to encourage parents to plan and to save for their children's education.

We cannot let this opportunity pass us by. The stakes are too high for our children and for the future of the country. America can remain strong and prosperous only so long as we maintain an informed and well educated citizenry.

Mr. Chairman, members of the Committee, thank you for this opportunity to speak this morning. If there any questions, I would be happy to answer them.

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John D. Finnerty, PhD.

A PRIVATE SOLUTION TO A PUBLIC PROBLEM℠: A RESPONSE FROM THE PRIVATE SECTOR TO THE COLLEGE SAVING CRISIS

I would like to thank the members of the Finance Committee for giving me this opportunity to present a response from the private sector to the college saving crisis, specifically, to discuss the daunting task that families face in trying to save for their children's college education and to suggest measures that can be taken to assist families in this important saving effort.

Briefly, I am the Executive Vice President and Chief Financial Officer of the College Savings Bank, a New Jersey-chartered, FDIC-insured savings bank located in Princeton, New Jersey. College Savings Bank was formed for the primary purpose of originating and marketing the CollegeSure℠ CD, a certificate of deposit designed to assure future funding of college costs.

Introduction

Most parents feel obligated to contribute toward the cost of their children's college education.[1] But only about half the families who plan to have one of their children attend college are currently saving for college, and the median savings level is under $600 per year. Even among families earning $30,000 or more per year, only 70% are saving for their children's college year. Those who are not currently saving for their children's college education but plan to do so later expect to start saving when their child is 12 years old, which only leaves six years to save before the child matriculates.[2] Such savings programs are likely to leave families financially unprepared to pay for their children's college education.

Dimensions of the College Saving Crisis

As college costs soar, more and more families are struggling with the task of planning how to finance the cost of their children's college education -- a cost that threatens to escalate beyond their reach. The persistently high rates of college inflation present an imposing challenge. Based on data compiled by the College Board, college costs at private institutions have increased since 1981 at an average rate of 10.0% per annum, more than double the rate of inflation in consumer prices.[3] Even at the 7.39% rate of college cost inflation for 1987, direct charges (tuition, mandatory fees, room and board) for four years at the average private institution, currently $11,312, would cost a member of the class of 2004 more than $125,000.[4]

Table 1 compares the rates of increase in direct charges at public and private universities to increases in the cost of various consumer goods and services and to changes in the average family's ability to pay for college, as measured by disposable personal income per capita and also by personal saving per capita. During each period, private university direct charges increased more rapidly than public university direct charges and also more rapidly than disposable personal income per capita. Also during each period, both private university and public university direct charges increased substantially faster than personal saving per capita. And Table 1 indicates that the gap between college costs and family savings is widening at an alarming rate. Within the past decade, public university and private university direct charges more than doubled, both increasing faster than disposable personal income per capita, but personal saving per capita increased only 16%.

The widening gulf between college costs and college savings is the result of two factors: the very high rate of college inflation relative to price inflation generally and the declining personal saving rate. Table 1 reports that university direct charges have increased substantially faster than consumer prices generally but more or less in line with the rising cost of medical care services, whose sharp rates of increase have

Table 1

Percentage Changes in Undergraduate Direct Charges, Personal Income and Saving Per Capita, and Consumer Prices, 1957-1986

	Percentage Change		
	1957to1986	1967to1986	1977to1986
Tuition, Fees, Room and Board:			
Private Universities	691.3%	366.4%	135.8%
Public Universities	431.0	264.5	101.4
Income and Saving Per Capita:			
Disposable Personal Income Per Capita	571.7	335.3	96.5
Personal Saving Per Capita	263.6	112.4	16.2
Consumer Prices: (a)			
All Items	289.6	228.4	80.9
Food	276.6	219.7	66.3
Rent (Residential)	220.0	180.0	82.4
Energy	311.0	270.3	78.6
Medical Care Services	615.4	368.6	116.2
All Services	429.8	300.5	106.1

(a) Based on year-to-year changes.

Sources: Digest of Education Statistics, Center for Education Statistics, U.S. Department of Education, Washington, DC, various issues, and Economic Report of the President, U.S. Government Printing Office, Washington, DC, January 1987, pp. 274-275, 307-310.

attracted considerable public attention in recent years. This reflects many parents' worst fears: having one child in college -- and a second one in the hospital.

The pattern of college costs relative to consumer price inflation depicted in Table 1 reflects the longer term historical trend in college inflation. A landmark study authored by William G. Bowen and presented to the Joint Economic Committee of Congress in 1969 reported that during the three "normal" peacetime periods between 1905 and 1966, direct costs per student increased at an average annual rate of 7.7% per annum, whereas an economy-wide cost index increased at an average annual rate of 1.9% per annum.[5] College educational costs rose more than four times as fast as costs did economy-wide.

Table 2 indicates the deterioration in the personal saving rate that has taken place since the early 1970s. The annual personal saving rate peaked at 9.4% in 1973 and has decreased more or less steadily since then to 3.9% in 1986 and a five-year average of only 5.5% for the period 1982 - 1986. Reliable direct data concerning saving rates for college are not available. However, because saving for a child's college education ranks first or second for most families who expect to send a child to college, the personal saving trend illustrated in Table 2 is probably indicative also of the trend in saving for college.[6]

Table 2

Number of Years' Saving to Fund One Year's Direct Charges

Period	Personal Saving Rate(a)	Direct Charges as % of Disposable Income Per Capita(b)		Number of Years' Saving to Fund One Year's Direct Charges(c)	
		Private Universities	Public Universities	Private Universities	Public Universities
1957-1961	6.7%	87.7%	45.7%	6.5 yrs	3.4 yrs
1962-1966	6.6	93.3	45.2	7.1	3.4
1967-1971	7.6	89.8	42.0	5.9	2.8
1972-1976	8.6	84.3	37.7	4.9	2.2
1977-1981	7.0	78.6	33.1	5.6	2.4
1982-1986	5.5	91.8	35.1	8.3	3.2

(a) Average annual value of personal saving as a percentage of disposable personal income.

(b) Average annual undergraduate tuition, fees, room, and board as a percentage of disposable personal income per capita.

(c) Average annual direct charges as a percentage of disposable personal income per capita divided by twice the average annual personal saving rate. Calculation assumes a family of four with two children both of whom will attend college.

Sources: Digest of Education Statistics, Center for Education Statistics, U.S. Department of Education, Washington, DC, various issues, and Economic Report of the President, U.S. Government Printing Office, Washington, DC, January 1987, pp. 274-275.

A perspective on the seriousness of the deterioration in the college saving rate is provided in Table 2. If the average level of personal saving for a typical family of four were dedicated entirely to paying college costs for the two children, it would take 8.3 years' savings, based on the five-year annual average for 1982 - 1986, to fund direct charges at the average private university -- up by two-thirds from the comparable period a decade ago -- and 3.2 years' savings to fund direct charges at the average public university -- up by half from the comparable period a decade ago. But savings are also required for other purposes and college costs include costs in addition to direct charges, so the situation is more serious than the one depicted in Table 2.

College costs are likely to continue outpacing consumer prices by a wide margin in the future and college savings, if present trends continue, will prove inadequate. Middle income families, who are to an increasing extent finding themselves with insufficient resources to pay the ever-increasing cost of college by themselves but with an overabundance of resources to qualify for financial aid are likely to be most seriously affected. These families need effective college saving vehicles and appropriate saving incentives to help them reach their college goals.

Features an Effective College Saving Vehicle Should Possess

The ideal college saving vehicle should possess, at a minimum, the following characteristics:

- Generate adequate after-tax returns to pay for college costs;
- Permit families to eliminate college cost inflation risk;
- Afford families the flexibility to apply the funds at any college of their choosing;
- Maintain adequate security for investors' funds;
- Provide for low entry cost in order to make the program accessible to families from across a broad income spectrum; and

- Impose no penalty if the child does not attend college.

The first two characteristics are particularly important from a financial standpoint. Any financial instrument, including a college savings plan, can be characterized in terms of its expected rate of return and its riskiness. Granting favored tax status increases the expected rate of return but does not reduce risk. Because both features affect any instrument's attractiveness relative to other alternatives, a program that grants tax incentives but does not do anything to help alleviate the college cost inflation risk that families face may have little impact on the volume of college saving, that is, unless that program gives families the flexibility to purchase investment vehicles that relieve them of that risk. Vehicles that eliminate college inflation risk are now available in the private sector. Also, several states have announced tuition prepayment plans that would enable families to eliminate college inflation risk, although only on a limited scale.

Approximately a dozen private colleges have introduced tuition futures programs. Of the six states that have approved similar programs, only Wyoming has made its program operational.[7] Both types of programs have come under heavy criticism. They tend to balkanize the country by tying plan participants to a particular college, in the case of college-sponsored plans, or to public institutions within a particular state, in the case of state-sponsored programs. They also involve a high degree of tax uncertainty and impose severe financial penalties if the child does not attend the participating college or group of colleges.[8] The private sector also offers a certificate of deposit-based program that eliminates college inflation risk, offers families the flexibility to use the funds at any college of their choosing, and does not impose a penalty if the child does not attend college.

Two states, Illinois and North Carolina, have introduced tax-exempt zero coupon bond college savings programs. Such plans provide the desired tax exemption, but they do not eliminate college cost inflation risk.[9] Also, these plans threaten to balkanize the country just like state-sponsored tuition prepayment programs.

Table 3 illustrates the importance of eliminating college cost inflation risk. Over the past 30 years, direct charges at private and public universities have increased more rapidly than consumer prices by an average of 256 basis points per annum and 112 basis points per annum, respectively. But during the 1980s, as during the 1960s, the college cost inflation margin is substantially greater. For example, during the 1980s, direct charges at private and public universities have increased more rapidly than consumer prices by an average of 443 basis points and 229 basis points per annum, respectively. By historical comparison, long-term bonds have produced an average annual pre-tax real rate of return of 220 basis points in the case of corporate bonds, and 160 basis points, in the case of Treasury bonds.[10] On an after-tax basis, only common stocks have produced sufficient rates of return -- and even then only on average -- to keep pace with rising college costs. As the events of October 19, 1987 so clearly demonstrate, common stocks are inherently a very risky investment.

Granting a tax incentive to college saving will help promote college saving but it represents only a partial solution to the problem; college cost inflation risk will remain. In addition, the Roper study mentioned earlier found that fewer than half the respondents would save more if the federal government granted a tax break for educational savings, but three-quarters of the respondents said they would shift existing savings to the tax-advantaged accounts.[11]

Addressing the risk dimension of the problem is critically important. The college-sponsored and state-sponsored tuition prepayment plans mentioned earlier have tried to address this problem, but they have not gone nearly far enough. As Table 3 illustrates, the volatility of college inflation increased substantially beginning in the late 1960s. While the period 1977-1986 is similar to the period 1957-1966 in that college inflation is very high relative to consumer price inflation generally, the volatility of college inflation is substantially greater in the past 10 years than in the earlier period. Over the past 10 years, high college cost inflation margins and high volatility of college inflation have converged. Glancing back at Table 2, it is not surprising, then, that the lowest savings rates -- and highest values for the number of years' saving to fund one year's direct charges -- are observed within the past 10 years.

Role of the Private Sector in Helping Resolve the College Saving Crisis

The private sector can play a significant role in helping families eliminate college cost inflation risk. Currently, there is a product on the market that enables families to eliminate college cost inflation risk.[12] However, that product is fully taxable. Achieving the most effective college savings incentive will no doubt require the cooperation of the private sector and the public sector in order to enable college savers to eliminate college cost inflation risk and achieve the maximum possible after-tax rates of return commensurate with the elimination of this risk.[13] At least two approaches are possible.

First, a state can use its current tax-exempt bonding authority to issue tuition prepayment products that are tax-exempt and that eliminate the consumer's college cost inflation risk. Such program proposals have been announced in California and Massachusetts. The principal benefit such programs have from a tax revenue standpoint is their revenue neutrality. They possess the critical features needed to spur college saving without any additional cost to the federal government.

An alternative approach that would also combine tax incentives and risk elimination could be developed at the federal level. A federal plan could be more beneficial to savers than state plans because a truly national plan would ensure the greatest freedom of college choice. Some form of education savings account, as would be authorized under S.1533 or S.1659, would provide a meaningful tax incentive to college saving and would also afford sufficient investment flexibility. Structuring the education savings account along the lines of an IRA would enable the program to utilize the IRA infrastructure the private sector already has in place.

Five bills (S.1533, S.1572, S.1659, S.1660, and S.1661) have been introduced in the U.S. Senate to create tax-favored education savings accounts, and two bills (S.1662 and S.1817) have been introduced to extend the tax advantages of U.S. savings bonds when the proceeds are used to pay for college. All would establish some form of tax incentive to promote saving for college. I believe the Committee should recommend a tax subsidy to college saving. But I also believe that it is important to design the subsidy so that it promotes college saving rather than mere tax avoidance. To do the most good, a federal college saving program should afford investors the flexibility to invest in vehicles that will enable them to eliminate college cost inflation risk, not just reduce their income tax liability. I am concerned that S.1662 and S.1817 would merely shift college savings from traditional investments to the tax-advantaged vehicle(s) and reduce federal tax revenues without generating much net additional savings.

Generating additional college savings is what this country really needs. By authorizing a qualified education savings account along the lines of the IRA account and permitting college savers reasonable investment latitude, I believe that a significant increase in college savings will result.

Table 1

Intensity of College Cost Inflation, 1957 - 1986

	Average Annual Percentage Increase in Direct Charges(a)		College Cost Inflation Margin(b)		Volatility of College Inflation(c)	
Period	Private Univ'ties	Public Univ'ties	Private Univ'ties	Public Univ'ties	Private Univ'ties	Public Univ'ties
1957-1961	5.8%	3.6%	4.3%	2.1%	1.3%	1.2%
1962-1966	5.5	4.3	3.9	2.7	0.8	1.4
1967-1971	6.6	6.2	2.0	1.6	2.3	3.0
1972-1976	6.9	5.6	(0.2)	(1.5)	2.5	3.0
1977-1981	9.6	8.4	(0.3)	(1.5)	2.8	3.4
1982-1986	9.8	7.3	6.0	3.5	3.0	2.1

(a) Average annual percentage increase in tuition, fees, room, and board.

(b) Average annual percentage increase in direct charges minus average annual percentage increase in the consumer price index.

(c) Calculated as the standard deviation of the annual college cost inflation rates within the period indicated.

Sources: *Digest of Education Statistics*, Center for Education Statistics, U.S. Department of Education, Washington, DC, various issues, and *Economic Report of the President*, U.S. Government Printing Office, Washington, DC, January 1987, pp. 311.

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[1] A recent survey found that 66% of the parents interviewed felt they had the primary responsibility for financing their children's college education. Roper Organization, "A National Study on Parental Savings for Children's Higher Education Expenses," National Institute of Independent Colleges and Universities, Washington, DC, August 1984, p. 5.

[2] *Ibid*., pp. 4, 11. The study found an overall median saving level of $517 per annum and a median saving level of $904 per annum for families with incomes of $30,000 or more. Adjusting these figures based on the change in the consumer price index since 1984 indicates median saving levels of $594 and $1,039 per annum, respectively. Not surprisingly, the study also found that 74% of the individuals surveyed favored some form of federal tax incentive to promote saving for college.

[3] The college cost inflation figure is based on the annual rate of change in direct charges at private colleges as measured by the Independent College 500™ Index (the IC 500™), which is prepared annually by the College Board. The index is described in "Independent College 500™ Index", College Scholarship Service, New York, July 31, 1987. During the period 1981 - 1987, the average annual rate of change in the CPI was 4.3% per annum.

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[4] The enrollment-weighted average direct charges for 1987-88 at the 500 private colleges that comprise the IC 500 are $11,312.

[5] William G. Bowen, "Economic Pressures on the Major Private Universities," in The Economics and Financing of Higher Education in the United States, submitted to the Joint Economic Committee, 91st Congress, Washington, DC, 1969, pp. 399-439. Bowen's study goes on to explain why college cost inflation should persistently outpace consumer price inflation.

[6] The Roper study cited in footnote 1 found that saving for a child's college education ranked as the second most important reason for saving, behind emergencies, but ahead of retirement and other purposes. Op.cit., p. 4.

[7] "State Saving Incentive and Prepaid Tuition Plans," Minnesota Higher Education Coordinating Board, St. Paul, MN, January 1988, provides a useful overview of these and other college saving programs. Duquesne University, which introduced the first college-sponsored plan in 1985, recently announced the suspension of its program. Joseph Michalak, "Duquesne Suspends Tuition Prepayment Plan," New York Times (March 6, 1988), p. 28. The legislatures of Florida, Indiana, Maine, Michigan, Tennessee, and Wyoming have authorized tuition futures programs. The governors of California and West Virginia have vetoed legislation that authorized prepayment plans in their states, in both cases because the governor regarded as too great the risks the state would have to bear. State Saving Incentive and Prepaid Tuition Plans, op.cit., p. 1.

[8] Michael S. McPherson and Mary S. Skinner, "Paying for College: A Lifetime Proposition," Brookings Review (Fall 1986), pp. 29-36.

[9] The principal features of these programs are described in the Minnesota study. State Saving Incentive and Prepaid Tuition Plans, op.cit.

[10] Stocks, Bonds, Bills, and Inflation, 1987 Yearbook, Ibbotson Associates, Inc., Chicago, 1987, p. 25.

[11] Op. cit., p. 5.

[12] "The CollegeSure Account Information Booklet," College Savings Bank, Princeton, NJ, 1988.

[13] McPherson and Skinner also argue in favor of such a subsidy in order to provide societal support for keeping a large parental role in paying for college. Op. cit., p. 34.

American Association of Community and Junior Colleges
American Association of State Colleges and Universities
American Council on Education
Association of American Universities
Association of Catholic Colleges and Universities
Association of Jesuit Colleges and Universities
Association of Urban Universities
Council of Independent Colleges
National Association for Equal Opportunity in Higher Education
National Association of College and University Business Officers
National Association of Independent Colleges and Universities
National Association of Schools and Colleges of the United Methodist Church
National Association of State Universities and Land-Grant Colleges
National Association of Student Financial Aid Administrators

This statement is submitted on behalf of several higher education associations in support of S. 1817, the Education Savings Act of 1987, S. 39, the Employee Educational Assistance Act, and other legislation that would provide significant assistance to hundreds of thousands of families and students in meeting the cost of higher education.

It is increasingly apparent that both parents and students need additional help in financing higher education. In real terms, college costs have increased and federal grant support has eroded throughout the 1980's. Elimination of Social Security educational benefits in the Omnibus Reconciliation Act of 1981 ended one of the largest federal sources of student support, which had been providing $2 billion annually in benefits to students who had a disabled or deceased parent. Since 1980, the value of Pell Grants has declined 13 percent and appropriations for Supplemental Grants have decreased 24 percent in constant dollars.

Funding for all federal grant programs has declined by about 10 percent since 1980. States and institutions have attempted to offset these decreases in federal aid by expanding their own programs of grant assistance. Funding for state grant aid has nearly doubled since 1980. Aid provided by educational institutions has more than doubled (and more than tripled at independent institutions). Taken together, grant assistance from all sources has increased by 30 percent since 1980, but college costs of attendance have increased by over 60 percent.

As grant aid has failed to keep pace with increases in college costs, students have had to rely increasingly on loans as the primary means of paying for college. As recently as a decade ago, loans represented about one fifth of student financial aid; today loans make up over half of all such assistance. The shift toward greater dependence on loans as a means of financing higher education has raised a number of concerns, including the growth in student loan defaults and a perception that students are increasingly making career and personal decisions based on the need for income to pay off their educational debts.

Education Savings Act

In the context of the growing costs of college attendance, the decline in the purchasing power of grants, and the increased dependence on loans, the need for incentives to encourage greater family savings in advance to meet educational expenses is evident. Increased savings could be an important way to make college costs more affordable and reduce dependence on loans. Incentives to save for college expenses could also be a means of raising the nation's overall savings rate, which is at a record low level since the Second World War.

Tuition savings plans such as S. 1817 -- along with other tax incentives targetted at students and families -- would provide a new means for helping to pay for the costs of higher education. The use of U.S. Savings Bonds as payment for tuition and fees without taxing the holder on the accrued interest offers a simple, productive, and workable incentive for families to plan for their children's education. It would also encourage families to consider college attendance for their children at an early age, and increase the expectation of college attendance for young people who are making course selections at the secondary level.

U.S. Savings Bonds are a familiar method of saving for many Americans, as well as one of the safest investments they could make. Using Savings Bonds as payment for tuition will encourage the sale of bonds at minimal cost to the Treasury.

The growing concern about the need to increase savings for college is reflected in the attention being devoted in the states to savings or tuition guarantee plans. A half-dozen states have followed the lead of Michigan in passing tuition guarantee plans (although only one, in Wyoming, is operational), several states including Illinois and North Carolina have passed savings plans, and most other states are examining the feasibility of such savings incentives. The state plans vary widely in their provisions, but they share the characteristic that the greatest benefits would accrue to students attending institutions within the state.

We believe that the prospective proliferation of state plans, and their resulting revenue loss, provide another strong reason for establishment of a national college savings plan such as S. 1817, to create incentives to save for college which offer the broadest possible choice. The best savings plan, in our judgment, is one that encourages students to attend the institution that best meets their interests and abilities.

This legislation will not require the establishment of a new Executive Branch bureaucracy to administer its benefits. Nor will it require new financial instruments, complex rules, or penalties for withdrawal.

In expressing our support for S. 1817, we would underline the strong statement of its sponsors that the program is not intended to provide an alternative for federal need-based student financial aid. The Pell Grant and other programs of grants, work, and loans for needy students form the basic core of support for millions of needy students, and the continued growth of these programs is essential to meet the national objective of equal educational opportunities. No savings plan can substitute for these programs: we are concerned, for example, that the Administration's proposal for a similar kind of savings bond plan is accompanied by recommendations to eliminate two major need-based programs (Perkins Loans and State Student Incentive Grants) which provide over a quarter of a billion dollars to over half a million needy students. Such a tradeoff is unacceptable.

Employee Educational Assistance

The Employee Educational Assistance Act contained in Section 127 of the Internal Revenue Code, providing tax-free educational assistance paid by employers for their employees, expired December 31, 1987. We urge prompt passage of S. 39 to renew this legislation and restore its benefits for the millions of Americans it assisted.

Since 1978, Section 127 has offered a dual incentive for employers and employees. It has encouraged employers to pay at least $70 million in tuition to promote the training and increase the technological skills of their work force. It has been used by more than seven million workers to obtain the specialized education they need for job advancement.

Renewal of the Act is important to colleges and universities because of the increasing numbers of students whose tuition is paid by corporate employers, and because it exempts from taxation the tuition remission benefits institutions provide for graduate teaching and research assistants and other employees.

The cost of Section 127 is relatively slight, but the return to society is substantial in terms of national needs for employment, retraining, technological advance, and opportunities for underemployed workers.

Other Related Issues

In addition to encouraging savings for college and renewing the Employee Educational Assistance Act, the nation's tax laws should be modified in several other respects to encourage the goal of assisting families and students to meet the costs of higher education. We urge the Committee to act on bills to restore the tax exemption for scholarships and fellowships and to reinstate the deduction of interest on educational loans.

Taxation of Scholarships. Scholarship and fellowship grants above the cost of tuition were specifically subjected to taxation for the first time by the Tax Reform Act of 1986. All grants to non-degree candidates are fully taxed, while degree candidates are taxed on the portion of their grants that exceeds tuition. Most institutions do not have the resources to cover this new tax liability by increasing the amount of their awards.

Scholarships and fellowships are the means by which we seek to assure that the nation has an adequate supply of highly trained men and women to meet its future needs. The policy of taxing these awards is self-defeating, requiring increased federal and institutional investment in student aid.

Therefore we urge restoration of the former tax treatment of scholarships and fellowships, as provided in HR 2649 and HR 2670. The revenue effect of this proposed change would not be significant, yet the impact on students with limited personal resources would be dramatic. Under the 1986 Act, income in excess of $4,950 for a single person (the combination of the standard deduction and personal exemption) is taxed at a rate of 15 percent; yet the poverty threshold for a single person is $5,800. For the low-income student, therefore, the taxation of a scholarship or fellowship results in real deprivation.

This change in the 1986 Act makes it more difficult for able students to pursue advanced studies, especially in fields that do not have a high income potential--at the same time the national interest clearly requires the encouragement of our very best talent to become scholars, teachers, and researchers.

Deduction for Interest on Educational Loans. The Tax Reform Act of 1986 also phased out deductions on all consumer loans over the next four years. The legislative history of the Act confirms that Congress was concerned with removing the deduction on consumer interest, while preserving the deductibility of investment interest. However, this change failed to take into account the serious impact of removing the deductibility of interest on student loans, which comprise over half of all federal student assistance.

Higher education is, without question, one of the most significant investments which our nation and our citizens can make. It is particularly important, in this period of rising costs, to effectively aid parents and students in meeting the expense of higher education. The opportunity to utilize home equity loans does not provide a suitable alternative for financing a college education when much of the population either does not own a home or has insufficient equity to apply to education.

We support enactment of S. 628, to restore the deduction of interest on student loans. This will not impose an unreasonable cost on the government: we estimate that it is not likely to exceed $150 million annually, which is minimal when compared to the benefit and relief which will be furnished to middle income students and families.

We ask the Committee to take action on these important tax provisions, which would have a dramatic beneficial impact on student and family financing of the cost of higher education.

Statement
# of the
American Association of Engineering Societies

The American Association of Engineering Societies (AAES) is pleased to present its views on S. 39, legislation introduced by Senator Daniel Moynihan to restore permanently the Section 127 tax code exclusion for employer-paid educational assistance. Section 127 expired at the end of 1987.

AAES is a multidisciplinary organization of professional engineering societies dedicated to advancing the knowledge, understanding, and practice of engineering in the public interest. Its member societies, which represent over half a million engineers in industry, government, and education, include:

- American Society of Civil Engineers
- American Institute of Mining, Metallurgical and Petroleum Engineers
- American Society of Mechanical Engineers
- Institute of Electrical and Electronics Engineers
- American Society for Engineering Education
- American Institute of Chemical Engineers
- National Institute of Ceramic Engineers
- Institute of Industrial Engineers
- Society of Women Engineers
- Society of Fire Protection Engineers
- American Institute of Plant Engineers
- American Nuclear Society
- American Indian Science and Engineering Society

AAES supports permanent extension of Section 127 of the Internal Revenue Code, which allows employers to reimburse employees for certain educational expenses without creating an added tax burden for the employee.

One of the goals of AAES is to ensure the technical competence of engineers throughout their working life. With rapid changes in technology, continuing education is especially critical for engineers to keep up to date in their field or to switch areas of engineering specialization. We wish to stress that continuing education has two functions: 1) to enable engineers to keep pace with rapidly changing technology in their field; and 2) to provide for retraining to ensure employability in developing fields and avoid unemployment in declining fields.

Section 127 of the Internal Revenue Code, scheduled to expire on December 31, 1987, allows employees to receive training and education courses for upgrading skills and learning new job responsibilities as part of an employer's tuition assistance program. When employees are reimbursed for the training and education (typically in-house, or at a community college or university), the employees are not taxed on that reimbursement as income.

In the absence of Section 127, employers and employees must use the Section 162 "job related" test. That test has serious ambiguities which will create uncertainty and have a chilling effect on employer support for continuing education.

Continuing education should be viewed as an investment, not a fringe benefit. It should be considered a business expense, required for a company to remain competitive and to increase productivity. With the appropriate mix of educational programs, we can improve our quality of life while improving the nation's industrial competitiveness and balance of trade; we can improve productivity while improving the quality of our products.

Given the constantly changing employment picture in the country, it is important for the Federal government to adopt policies that encourage employees to obtain retraining and advance knowledge and skills through employer-provided educational assistance. At a time when we have a critical need to develop the quality of the work force and improve national productivity, we should not deliberately restrain an efficient technique for improving human capital.

The present rapid rate of scientific and technical innovations has given new emphasis to the need for engineers and technicians to enhance and renew their technical competence on a continual basis. The individual engineer has personal responsibility to plan and develop a program for life-long learning that will assure his or her continued technical renewal. Each year, the technical competence of the engineer must be expanded so that he or she is prepared to undertake, next year, tasks for which the background was not available last year.

Similarly, the employer has a responsibility to encourage and assist the engineer in improving technical competence. Challenging job assignments must be provided; time and opportunities for formal courses must be made a part of the working environment; recognition must be provided to those engineers who do enhance their technical competence and, thus, increase their ability to contribute to the performance and profitability of the employer.

Unless appropriate steps are taken continually to encourage technical competence, every engineer faces the threat of technical obsolescence. Life-long learning -- in the broad sense -- must be pursued if technical obsolescence and its undesirable consequences are to be avoided.

To illustrate the importance of Section 127, we offer two examples of how it affects workers of different ages. In 1979, a 55 year-old aerospace engineer found himself not working on a space program because his employer re-assigned him to a synthetic fuels project. Even though his undergraduate education, made possible by the GI bill, allowed him to help put a man on the moon, he required retraining to apply his engineering knowledge to a program trying to ensure the nation's energy independence. Clearly such continuing education should not be considered a fringe benefit. It is a means for that person to grow professionally and maintain the competence necessary to stay employed.

In 1985, a 29 year-old welder is facing unemployment because the steel industry for which he has been working cannot compete with the Japanese steel industry. The welder could be retrained for employment as a welding inspector in another industry or possibly enter a program in computer-aided manufacturing to help revive the competitiveness of the U.S. steel industry. Such retraining should not be treated as a fringe benefit, taxable to the welder. Without Section 127, it is unclear whether it would quality as 'job related' under Section 162.

These examples demonstrate that failure to provide continuing education and retraining could result in unemployment, and hence a lower tax base. More importantly, middle income workers who would benefit the most from employer educational assistance to enhance their job skills would be hurt the most and unemployed first.

Congress has long debated the need and methods for improving skills of the work force to maintain employment and compete in international markets. Congress has also expressed concern about commercial utilization of technology. Unless engineers and others in the work force have the ability to move easily from one technical project to another, much technology with commercial potential will continue to collect dust on shelves. For new, efficient technologies to be implemented successfully, thousands of engineers and technicians will need to learn new skills through continuing education. Exempting tuition reimbursement from taxable income would greatly facilitate this process. It should be noted that in its final report, Global Competition: The New Reality, the President's Commission on Industrial Competitiveness recognized the importance of Section 127 and urged Congress to extend the provision.

In conclusion, we believe that employer expenses for employee education are legitimate business expenses that should not be taxable income to the employee and that Congress should approve the permanent extension of Section 127. Continuing education is a cost-effective investment, not a fringe benefit.

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ASSOCIATION

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TAX LEGISLATIVE REPRESENTATIVE
Linda S. Rearick
202/663-5322

April 12, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Comments submitted for March 15 Hearing on Tax Incentives for Education

Dear Mr. Chairman:

The American Bankers Association (ABA) urges the Committee to report favorably legislation to restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace.

The ABA is the national trade and professional association for America's commercial banks of all sizes and types. Assets of ABA member banks are about 95 percent of the industry total. Education assistance is an important fringe benefit for many bank employees, and in light of future trends should continue to be an important benefit.

Recently a Future Issues Task Force of the ABA presented its report highlighting the anticipated changes in banking's operating environment and the issues which will be critical to banking's future success. One of eight recurring themes identified by the task force was that banking's work force must be retrofitted for the new financial services environment. Changes in products, marketing and technology are causing the skills of much of banking's work force to be obsolete. Automation and the need for all front line employees to be skilled marketers will mean that many bank employees, like tellers, will be responsible for a broader range of more challenging tasks. Where once, banks had a need for employees with only high school educations, higher education requirements will be required. Workers with relevant skills will become harder to find.

Apparently this trend is not unique to the banking industry. An article entitled "Tomorrow's Jobs: Plentiful, But..." by Louis S. Richman in the April 11, 1988 issue of PORTUNE magazine noted that, "all is not joy in the new job market."

> "One problem: a growing mismatch between the emerging jobs, which will call for increasingly higher levels of skill, and the people available to fill them."

Because the pool of skilled labor will not be large enough to meet the demand, the burden of educating employees to the necessary levels will increasingly fall on the corporations who need the more skilled labor. Much of that training may not fit under the standards that will allow an employer to provide education to an employee without the value of that assistance being subject to tax.

If the value of the education or training is taxable to the employee, many employees may be unwilling to participate in the new training. Already this year, banking schools are reporting a declining enrollment of students. The directors of these schools attribute the decline to the expiration of the education assistance income exclusion.

The American Bankers Association urges you and your colleagues on the Senate Finance Committee to make passage of legislation to permanently reinstate the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Mr. Chairman, the Committee's hearing on March 15 also included consideration of a number of proposals to provide for education savings bonds or education savings accounts. In light of the coming need for a better educated work force, we commend your consideration of these proposals and recommend that the Committee give greater consideration to education savings account proposals which allow each individual or family the flexibility to save through the investment instrument which best suits their needs.

Thank you for your consideration of our views.

Respectfully,

Linda S. Rearick

Linda S. Rearick

AT&T

Harold W. Burlingame
Senior Vice President

Room 29-3314
550 Madison Avenue
New York, NY 10022-3297
212 644-1000

April 8, 1988

The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate
703 Senate Hart Office Bldg.
Washington, D.C. 20510

Dear Senator Bentsen,

I am writing to express AT&T's support for Senate bill 39, which would reinstate section 127 of the Internal Revenue Code. Failure to reinstate will have a profound negative impact on the U.S business environment and on the education profile of the population in general.

In our changing technological environment, AT&T has encouraged the efforts of our employee body to update their skills through internal training programs and external education sources (colleges and universities, technical training programs, adult education programs). We and other companies have put in place sophisticated tuition assistance programs which subsidize the education endeavors of our employees. To be competitive in the global marketplace, the United States and AT&T as well, will need to take an active position in support of education at all levels and for people in every occupation. The ability to educate or re-educate themselves through participation in our country's education system allows our employees to obtain the flexibility of skills and knowledge necessary to maintain a competitive edge.

Tax exempt education assistance has enabled corporate America to partner with the country's education professionals to develop innovative programs that address a cross section of learning needs from on-site degree programs to classroom instruction received by remote satellite transmission. Employees taking advantage of the opportunity to learn range from the physicist to the mail clerk.

If no action is taken to renew Section 127, or put in place an alternative which eliminates or minimizes the tax consequences of education, the adult learner population will be severely affected. For instance, a married employee claiming four dependants in a semi-skilled position with an annual salary of $25,000, would be severely impacted by the taxation of tuition assistance. Assuming this employee is paid bi-weekly, the employee's gross wage is $962 and after-tax disposal income is $784. If $1,500 of tuition reimbursement was imputed income to this employee, the employee's income tax withholding will increase by $420, resulting in a after tax income for the pay period of only $364.

The existence of Section 127 and Congress' extension of it in the past has supported the notion that our government has made education a top priority. The reinstitution of an education assistance tax exemption will permit the United States to take a premier competitive position in the global marketplace.

We are sending copies of this letter to the Finance Committee with a request that it be included in the record of the hearing held on March 15, 1988 on tax incentives for education.

Sincerely yours,

H W Burlingame

H.W. Burlingame

American
Dental
Association

1111 14th Street, N.W.
Suite 1200
Washington, D.C. 20005
(202) 898-2400

March 28, 1988

The Honorable Lloyd Bentsen
Chairman
Finance Committee
703 Senate Hart Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The American Dental Association appreciates this opportunity to state its position regarding tax incentives for education and asks that this letter be included in the record of the recent hearings held by the Committee on Finance on the issue of educational assistance.

Tax policy that supports educational endeavors is essential to continuation of a coherent federal education policy. We believe the 1986 Tax Reform Act, in its treatment of the interest on education loans as being no different from the interest on consumer loans, is inconsistent with federal education policy and should be corrected by restoring full deductibility of educational loan interest.

This is a critical matter to dental students and recently graduated dentists because of the dual high costs of dental education and establishing a dental practice.

The average cost today of a dental education is nearly $50,000. This is exclusive of normal living expenses, which may easily add another $40,000 to the four-year total. Average indebtedness of dental students in 1987 was $39,200. It is not uncommon for dental students to graduate with debts in excess of $60,000.

The cost of beginning a dental practice in the most conservative circumstance -- a single-operatory office -- averages $75,000, largely due to the high cost of instruments and equipment. The Association recognizes that these substantial expenses represent an investment in a lifetime profession. But they also represent a contribution to the health of the public. Moreover, federal financial support for higher education is essential to assuring educational opportunities for all deserving students. Tax policy which has the effect of lessening that support is incongruous with the principle of equal opportunity in education.

The Association urges you to support restoration of full tax deductibility of educational loan interest.

Sincerely,

William E. Allen, D.D.S.
Director
Washington Office

STATEMENT OF
THE AMERICAN ASSOCIATION OF DENTAL SCHOOLS

The American Association of Dental Schools represents all of the dental schools in the United States, as well as advanced education, hospital, and allied dental health institutions. AADS is the only national organization exclusively concerned with the needs of dental education.

Our Association urges restoration of the tax deduction for interest on educational loans. We support the passage of S. 628, which would restore this important deduction.

The phase-out of consumer loan interest deductions under the Tax Reform Act of 1986 included educational loans in the same category as consumer loans. The policy rationale for eliminating the consumer loan interest deduction was to discourage over-reliance on credit and to encourage savings, but we believe this rationale is not applicable to educational loans. Borrowing is often the only means to finance an education, particularly in expensive graduate health programs such as dentistry. Borrowing for educational purposes is also a good investment in the future, rather than a needless debt for a non-essential consumer product. The remaining interest deduction -- for home equity loans used for educational purposes -- is not an adequate substitute, since most of the student population does not own a home and cannot benefit from this deduction.

The Debt Burden Problem

The growing debt burden for dental students may discourage entry into the profession, and has deterred graduates from taking lower-paying public service, teaching, or research jobs. It may also discourage students from pursuing advanced education programs such as General Dentistry residencies -- programs that are aimed at training dentists to treat medically underserved patient populations and geographic areas. The 1987 AADS survey of dental school seniors shows an average debt of $39,200 for graduates of all dental schools; 29.5 percent graduated with a debt greater than $55,000. Dental students have also accumulated an average debt of $4430 for their undergraduate studies. Restoration of the interest deduction for educational loans would be a step in the right direction toward alleviating this burden. The estimated revenue loss of $150 million annually is small compared to the benefits of investing in health professionals for the nation's growing health care needs. We believe that it is sound tax policy to allow tax deductions for educational costs necessary to assure a highly competent cadre of health care professionals.

Equity of Restoring the Interest Deduction

The document prepared by the staff of the Joint Tax Committee for the March 15 hearing cited a main objection that restoration of this deduction would be a greater benefit to higher income individuals, and would be financially insignificant. We disagree with this assessment for the reasons outlined below, in response to the questions raised about restoration of the deduction.

(a) Would S. 628 encourage unneeded borrowing for education or other purposes? This would be unlikely, since a tax-exempt grant to cover tuition is inherently preferable to taking out a loan. Also, needs analysis tests, and income limits for low interest loan programs, eliminate the possiblity of high income individuals using low interest educational loans for non-educational purposes.

(b) Is this deduction a greater aid to higher income individuals in the higher tax brackets? This should not be a major problem, since the Tax Reform Act of 1986 eliminated a number of higher tax brackets and provided for only two individual brackets of 15 and 28 percent. Moreover, the deduction is most valuable for the practitioner when his or her earnings are low and interest payments are high; this is the situation faced by most young dentists in the first 3 years after graduation.

(c) Will there be only slight monetary relief for the student from such a deduction? Based on the debt burden we have discussed above, we believe the answer is no. First, while this deduction is not the only solution to the debt problem, the inability to be a cure-all would not eliminate its usefulness. Second, the relief is important in light of heavily indebted dental school graduates. Let me illustrate one simplified example: a dental student graduating with an average 1987 debt of $39,000, with a HPSL loan at 9 percent interest repayable over 10 years. The average monthly payment required to amortize this loan would be about $500. This works out to a total repayment figure of $60,000, meaning that about $21,000 accounts for interest over the life of the loan. However, the first year interest is a higher proportion of the principal due: $3510 out of the $6000 first year payment accounts for interest. Therefore, a tax deduction for this amount in the first year equals a tax savings of $526 if taxed at the 15 percent bracket, and $982 if taxed at the 28 percent bracket (the later figure is an approximation, since overall income is taxed at 15 percent up to $28,000 of income, and then at 28 percent of the excess income). We believe this would be an important aid to graduating health professions students just beginning their careers.

(d) Will only high income individuals who itemize their deductions be able to utilize this deduction? Technically, a deduction for interest would not be used if individuals take the standard deduction under 26 U.S.C. section 63 (b) (2): $5000 for a joint return, $4000 for a head of a household, and $3000 for single filers. It is not clear that only high income individuals will elect to itemize deductions. Any individual whose total deductions exceed the standard figure should elect to itemize. Educational interest alone may equal these standard figures, if educational loan interest were fully deductible as proposed in S. 628. In considering whether an individual would elect to itemize, it is likely that many middle income individuals will have sufficient additional deductions to push them over the standard deduction level. Only the lowest income individuals would be unlikely to itemize, but these individuals in dental schools and other health professions schools would also be less likely to have heavy educational debts; they are likely to qualify for scholarships and other grants. Given the existing debt burden, we believe it makes better policy sense to give students the benefit of the doubt by restoring the deduction, and then examining tax data to see how many itemize deductions under the new tax system.

Thank you for consideration of these comments on the need to restore the deductibility of interest on educational loans.

Submitted Testimony of Arnold Cantor
American Federation of Labor and Congress of Industrial Organizations
To the U.S. Senate Committee on Finance
on Renewal of Employee Educational Assistance (S. 39)

March 15, 1988

The AFL-CIO strongly supports maximum opportunity for all workers to maintain, upgrade, and adapt their educational achievements and their skills. Such opportunities enhance national productivity and competitiveness as well as supporting individual workers in their efforts to achieve personal development and self-fulfillment.

Therefore, we reaffirm our support for legislation to restore section 127 of the Internal Revenue Code, which, before 1988, provided a limited income tax exclusion for employer-paid career-related educational expenses.

The AFL-CIO has consistently supported a fair tax system that closes loopholes and provides revenue needed to operate the federal government and promote national goals. We believe the exclusion of employer provided education assistance is consistent with a fair tax system and promotes the national goal of increased opportunities for education and training.

The AFL-CIO also supports reinstatement of section 127 because such Congressional action would exclude from taxable income the value of tuition reductions for graduate students . The Tax Reform Act of 1986 requires graduate assistants to pay tax on tuition reductions and elimination of the exclusion would require many students to abandon their studies.

The immediate cost of the credit for workers' education and training to the nation's taxpayers is minimal and to the extent it enhances educational opportunities and provides economic and social benefits, it clearly qualifies as an investment in a national asset, not as cost to be cut in order to reduce the federal budget deficit.

The exclusion unlike many tax preferences also extended benefits in conformance with Congressional intent and provided benefits as prescribed by the legislation. In addition, the amount of the exclusion is "capped," limiting the potential loss of revenue and preventing a privileged elite from taking advantage of the benefits.

To qualify for the exclusion, an employer must draw up for employees' exclusive use a detailed written plan, which may not favor company officers, business owners or highly compensated employees. Employees also may not choose between the education benefit and taxable remuneration and the amount of the exclusion can not exceed $5,250.

negotiated collective bargaining agreements that include education and training benefits to improve skills and provide America with a more skilled, better education and more adaptable workforce.

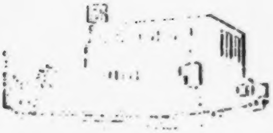
Some examples include:

- Approximately 50,000 health care workers in New York City are eligible to receive education and training benefits from a pooled fund provided by employers in a contract negotiated by the Retail, Wholesale and Department Store Union. The money is used to school health care workers in new technologies, train prospective registered nurses to help eliminate nursing shortages and provide other benefits to workers and the health care industry.
- Some 285,000 Communications Workers employed by the Bell Telephone Companies are eligible for education programs, that can lead to jobs at higher classifications, which in some cases raise salaries by as much as $250 per week.
- Since 1983, 45,000 auto workers at Ford Motor Company have participated in training, retraining and other programs, many of which teach basic skills at plant sites around the country. General Motors has contributed $200 million annually under an agreement with the UAW that pays for instruction in job skills and basic education.
- The Office and Professional Employees International Union has negotiated contracts that reimburse tuition costs in lieu of wages for up to 10,000 office workers at colleges and universities who want to study at their campus workplaces.
- The Service Employees International Union negotiated the Lifelong Education and Development (LEAD) program, which provides instruction in adult literacy, high school equivalency, English as a second language, health care apprenticeships and other services to bolster workers' professional development. In one case, a local Service Employees union local prevented displacement of 40 hospital supply aides with a program to retrain workers and upgrade their skills to help employees advance to higher level positions in another department.

As policy makers look to a first-rate educational system as the foundation for efforts to strengthen America, we believe a serious mistake would be made by requiring workers to pay income tax on a vital training benefit and taxing students' tuition reductions. Both tax benefits serve the nation's interests.

Therefore, we urge the United States Congress to restore Section 127 of the Internal Revenue Code.

**PEOPLES
BANK
AND TRUST
COMPANY**
CEDAR RAPIDS, IOWA 52406
PHONE (319) 364-0181



March 30, 1988

The Honorable Lloyd Bentsen, Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

As a National Director for the American Institute of Banking and a Senior Vice President of the Peoples Bank of Cedar Rapids, Iowa, I am concerned about the taxation of educational assistance that employees receive. It is extremely difficult to obtain an employee who is fully knowledgeable in all areas of our business upon hiring. It therefore becomes important that we be able to educate those people and our existing employees in the skills to keep us current in today's changing world.

Studies have shown that we are entering a period in which we will be faced with declining numbers of young, entry-level employees. This is happening at the same time that the skills levels needed by our employees are reaching their highest levels. It has been shown that 50% of the nation's businesses will introduce new technologies within the next five years. This will be happening at the same time that 50% of today's college graduates will be changing fields of employment. The need for education and training has never been higher.

One needs only to look at our foreign competitors to see the emphasis that should be put on education. The Japanese, Germans, and Russians (just to name a few) are putting a large emphasis on employee education.

I know that it is not your intention to reduce the amount of education available to people, but this may be exactly what is going to happen. When a lower-level employee is faced with the need to pay taxes upon education needed in their jobs, they in many cases may be forced to forego this training. This would be done not because they didn't want the education, but simply because they could not afford to take away from their salary to pay the tax. It would seem to me that this is certainly not what you want to happen.

I encourage you and your committee to report favorably upon Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. This Section expired on December 31. 1987.

Thank you for your consideration of this matter.

Sincerely,

James L. West

James L. West
Senior Vice President

American Institute of Banking
Rock Valley Chapter

AMERICAN
BANKERS
ASSOCIATION

April 6, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington D.C. 20510

Comments submitted for March 15 hearing on Tax Incentives for Education

Dear Mr. Chairman:

The Rock Valley chapter of the American Institute of Banking (AIB) urges the Committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

During the 1987-88 educational year, our chapter offered 17 courses and 6 seminars related to the financial education. Those numbers produced 797 students, employees of financial institutions who want and need continuing education. Many of those individuals would be penalized for wanting to better themselves. By instituting a withholding on income, single parents who can not afford additional expenses will be discouraged to seek education. I can think of three (3) individulas at my place of employment who fit the above role. Consideration must be given to the continual retraining in the workplace.

Today, AIB is the largest educational division of the American Bankers Association. Four hundred chapters enroll 35,000 persons each year in education and training programs. Admission to AIB is available to employees, officers, and directors of banks. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will qualify them for career advancement.

By participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Service, Securities Services, Supervisory Skills, and Accelerated Banking Study.

Most banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The Rock Valley chapter of the American Institute of Banking urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

Albert F. Kempfer
President
Rock Valley Chapter
American Institute of Banking
Vice President, Real Estate Department
Rock County National Bank

AIB

March 30, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Comments submitted for March 15th hearing on Tax Incentives for Education

Dear Mr. Chairman:

The Southeastern Michigan chapter of the American Institute of Banking (AIB) urges the committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

The Southeastern Michigan was formed in 1900. This local educational program consists of classes and seminars in areas specifically related to the banking industry. Several local institutions of higher education have an affiliation with the Chapter Office whereby earned in classes and seminars annually. Diplomas in eight programs are conferred annually to approximately 200 recipients.

Today, AIB is the largest educational division of the American Bankers Association. Four hundred chapters enroll 350,000 persons each year in education and training programs. Admission to AIB is available to employees, officers, and directors of banks. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will qualify them for career advancement.

By participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Service, Securities Services, Supervisory Skills, and Accelerated Banking Study.

Most banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The Southeastern Michigan Chapter of the American Institute of Banking urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

Parker A. Moore

Parker A. Moore
Executive Director

PAM/jvg

Southeastern Michigan Chapter • American Institute of Banking
Ford Building • Suite 1505, 615 Griswold • Detroit, MI 48226 (313) 965-0914

The American Institute of Chemists, Inc.
7315 Wisconsin Avenue, Bethesda, Maryland 20814 / 301 652 244

Dr. James N. BeMiller, FAIC
President 1988-89
Center for Carbohydrate Chemistry, Smith Hall
Purdue University
West Lafayette, Indiana 47907
(317) 494-5684

April 5, 1988

Hon. Lloyd Bentsen, Chairman
Senate Finance Committee
Room SD-205
U.S. Congress
Washington, D.C. 20510

Dear Senator Bentsen:

I am writing on behalf of The American Institute of Chemists to urge your Committee's early and favorable consideration of S. 39. This bill would grant individuals an income tax exemption of $5250 yearly for educational expenses paid on their behalf by their employers. This exemption has been a long standing policy of the Congress, as evidenced by regular legislative exclusion of this presumed tax liability. Also Congress imposed the current $5250 cap on such exemptions.

Our Institute consistently has urged Congress to support this exemption and moreover to make it permanent. If enforced, the current law could impose an undue tax liability on chemists and others who are virtually required by the nature of their profession to pursue continuing education as a means of keeping abreast in their field. Often, that occurs because employers also recognize that need and subsidize it through tuition or other payments for their employees.

As we have said before, science is not static. It is ever changing, and it is important that chemists keep abreast of those changes in the interest of maintaining America's technologically competitive edge. To penalize them through taxation for doing what is necessary in order to be diligent is unfair, inequitable, and sending the wrong message to the next generation of chemists. Even now, those young people are being inculcated with the notion of continuing their education throughout their professional lives, not stopping it when they receive their final degrees in science from a national college or university.

Our national nonprofit organization has been advancing this concept ever since its founding in 1923, and will continue to do so. I hope that you may be able to circulate a copy of this letter to the other members of your committe. Thank you for your consideration.

Sincerely yours,

James N. BeMiller

cc: Bob Packwood
Dr. Fred Leavitt

Albuquerque Chapter
American Institute of Banking

320 Gold SW, Suite 1208 • Albuquerque, New Mexico 87102 • (505) 247-9298

March 28, 1988

The Honorable Lloyd Bentsen, Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington DC 20510

Dear Mr. Chairman:

The Albuquerque Chapter of the American Institute of Banking (AIB) urges the Committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the work place. Much of this training will be lost if Congress fails to act to restore this provision.

The Albuquerque Chapter was charted in 1946 and has been of service to our bankers since that time. It is the primary educational service for banker education in our community. Last year we enrolled approximately 1300 students in short courses and full semester classes on banking.

Today, AIB is the largest educational division of the American Bankers Association. Four hundred chapters enroll 350,000 persons each year in education and training programs. Admission to AIB is available to employees, officers, and directors of banks. Admission to AIB is available to employees, officers, and directors of banks. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will quality them for career advancement.

By participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Service, Securities Services, Supervisory Skills, and Accelerated Banking Study. Most banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The Albuquerque Chapter of the American Institute of Banking urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

Barb Daugherty

Barb Daugherty, Program Director
Albuquerque Chapter of the American Institute of Banking

AMERICAN INSTITUTE OF BANKING
ATHENS AREA CHAPTER ATHENS, GEORGIA

March 28, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The Athens Area Chapter of the American Institute of Banking (AIB) urges the committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

The Athens Area Chapter has been training employees of the area banks for almost two decades, mostly drawing on the talent of its various bankers as instructors. The twenty eight member banks have come to rely upon the (AIB) as a valuable educational tool for their employees.

Today, AIB is the largest educational division of the American Bankers Association. Four hundred chapters enroll 350,000 persons each year in education and training programs. Admission to AIB is available to employees, officers, and directors of banks. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will qualify them for career advancement.

By participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Service, Securities Services, Supervisory Skills, and Accelerated Banking Study.

Most banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The Athens Area Chapter of the American Institute of Banking urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

D Wayne Braswell

D. Wayne Braswell
President Athens Area Chapter
American Institute of Banking

AIB
IN DENVER
American Institute of Banking in Denver · 1050 17th Street · Suite 390 · Denver · Colorado · 80265 303/573-0556

April 6, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The Denver Chapter of the American Institute of Banking (AIB) urges the Committee to report favorable Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

The AIB is the largest education division of the American Bankers Association. Four hundred chapters enroll 350,000 persons each year in education and training programs. Admission to AIB is available to bank employees, officers and directors. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will qualify them for career advancement.

The American Institute of Banking in Denver is one of the largest chapters in this country, providing cost-effective industry specific education and training to the Denver metro area and the surrounding rural areas in Colorado. Our program is available to over 18,000 individuals employed in the financial services industry. Denver AIB was formed in 1901 and serves as the only education and training resource to many organizations in our state. By participating in these programs, they in turn help their respective organizations to compete in today's fast changing economic environment.

By participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Service, Securities Services, Supervisory Skills, and Accelerated Banking Study.

Most banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The Denver chapter of the American Institute of Banking urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

Kathy Collins Smith

Kathy Collins Smith
President and CEO

AMERICAN INSTITUTE OF BANKING
EASTERN CONNECTICUT CHAPTER
A 1987 Chapter of Excellence

The Honorable Lloyd Benson
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

The Eastern Connecticut Chapter of the American Institute of Banking (AIB) urges the Committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. This exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

Our Chapter has been in existence for forty one (41) years. We have educated thousands of bankers during that time from entry level employees to senior management. Our mission has always been to serve the banking community by providing excellent education on a cost-effective basis for our local area.

Today, AIB is the largest educational division of the American Bankers Association. Four hundred chapters enroll 350,000 persons each year in education and training programs. Admission to AIB is available to employees, officers, and directors of banks. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will qualify them for career advancement.

By participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Service, Securities Services, Supervisory Skills, and Accelerated Banking Study.

Most banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee educational assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The Eastern Connecticut Chapter urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

Patricia A. Daviau
President

AMERICAN
BANKERS
ASSOCIATION

AIB
AMERICAN INSTITUTE OF BANKING
A SERVICE OF THE AMERICAN BANKERS ASSOCIATION
LOUISVILLE CHAPTER

April 7, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Comments submitted for March 15 hearing on Tax Incentives for Education

Dear Mr. Chairman:

The Louisville Chapter of the American Institute of Banking (AIB) urges the Committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

The Louisville Chapter-AIB provides banking education and training to approximately 1500 bank employees a year. Our banks encourage employee participation in AIB not only as an employee benefit for up to date training but also for career advancement.

We are concerned that to tax this education assistance as income will discourage or prevent employees from seeking on the job training or new skills training for better jobs. Higher levels of education are so critical in today's workplace, why do we want to implement a tax measure that would burden and suppress this important element? How does the minimum wage and low income earner receive better jobs without education or training, yet can he afford to pay a price for it when available - via taxes?

If we encourage people to take steps for better jobs with higher salaries, then you also increase your taxable income base. But, this way you receive benefits on both sides - better jobs with higher income for the worker and an increase in taxes received by the government!

Please consider the impact IRC Section 127 has on education associations & colleges, employers and most of all, the employee. The Louisville Chapter-AIB urges you to make passage of legislation to reinstate permanently the IRC Section 127, exclusion for employer-paid tuition assistance, one of your top priorities for 1988.

Thank you for your time and considerations.

Respectfully,

Paula

Paula B. Cravens
Education Director

The American Society of Mechanical Engineers

The American Society of Mechanical Engineers (ASME) strongly supports Senator Daniel Moynihan's bill, S. 39, which would restore permanently the Section 127 tax code exclusion for employer-paid educational assistance. Section 127 expired on December 31, 1987.

Pressures of international economic competition are shaping a new environment for employer - employee relationships that require job flexibility, job mobility, frequent updating of skills and retraining. The American demographic trend toward an older work force, the continuing shift toward a service economy and rapid advances in knowledge and technology clearly point to the need for a public policy which supports and encourages the existing work force to pursue lifelong education.

Continuing education and retraining are especially critical for engineers to keep up to date with rapidly changing technology in their field or to switch areas of engineering specialization. In today's world of fierce international competition, a well-trained engineering work force is vital to the nation's well-being.

Congress also has expressed concern about commercial utilization of technology. Unless engineers and others in the work force have the ability to move easily from one technical project to another, much technology with commercial potential will continue to collect dust on shelves.

Since 1978, more than seven million workers have used employer-paid educational assistance to upgrade their skills to stay current with new competitive, technological and industrial developments. Over 95 percent of the participants in ASME's continuing education courses since the outset of its professional development program have been supported by their employers through tuition reimbursement. A nationwide survey conducted by the American Society for Training and Development in 1985 found that employee educational assistance.

Until its expiration, Section 127 of the Internal Revenue Code exempted qualified employer educational assistance from employee federal income taxes. The Section's expiration now causes confusion and concern among employers on their withholding and reporting liability for employees using their educational assistance programs. In the absence of Section 127, the law requires employees to pay taxes on tuition payments made by their employers unless the courses are strictly "job-related." This test has serious ambiguities which will create uncertainty and have a chilling effect on employer support for continuing education.

Reinstating Section 127 would be analogous to the GI Bill of Rights which provides for an investment in the future. Continuing education should be viewed as an investment, not a fringe benefit. It should be considered a business expense, required for a company to remain competitive. With the appropriate mix of educational programs, we can improve our quality of life while improving the nation's industrial competitiveness and balance of trade; we can improve productivity while also improving the quality of our products.

Finally, we challenge the presumption that Section 127 is a revenue loser for the Federal treasury. We believe the revenue forgone from not taxing employer educational assistance would be recovered many times over in additional tax revenues from economic activities generated by a continuously employed, well-educated work force. It should also be noted that the "cost" of Section 127 is very low compared to the alternative of expanding direct funding of educational programs and retraining.

In conclusion, we respectfully urge the members of the Committee to move expeditiously to approve S. 39 to make Section 127 a permanent part of the Internal Revenue Code. It is a critical component of the national effort to enhance the education, job skills and retraining of American workers. Clearly, Section 127 is a cost-effective investment in the future of America.

American Society for Personnel Administration

The American Society for Personnel Administration (ASPA) is an international society of more than 40,000 individual human resource professionals in organizations employing over 40 million workers. With more than 600 affiliated chapters and representation in every state in the union, ASPA is recognized as the world's largest organization dedicated solely to excellence in human resource management.

ASPA is a member of the Coalition for Employee Educational Assistance which presented testimony on S. 39 before the Senate Finance Committee on March 15, 1988. Because ASPA feels very strongly about the need for the Senate to enact S. 39, and reinstate Section 127 of the Internal Revenue Code, we are submitting this additional statement for the Committee's record.

As the individuals charged with initiating, implementing and administering employee benefit programs in corporations throughout the country, ASPA members have first hand knowledge of the value of tuition reimbursement programs as an employee benefit and as a tool to train workers for the future. They have witnessed how the expiration of Section 127 of the tax code has reduced or eliminated the benefit for workers around the country. By adding a new tax obligation on employees receiving this benefit, and imposing a "cost" on workers, Congress has eliminated a major incentive for employees to undertake additional job enhancing training - the incentive of "no cost". Where employees could have received additional education at no personal expense beyond their own time and commitment, they now must determine if they are financially able to enroll in a program of advanced education.

There is no question that tuition reimbursement programs are attractive to employees. A 1985 survey by the American Society for Training and Development showed that 96% of the respondents used educational assistance for improving skills and performance on the job and 54.8% said educational assistance helped employees learn basic skills like reading and writing. Most important perhaps, was the fact that 72% of employees taking education and training courses earned less than $30,000 a year.

ASPA recognizes that the Congress is confronted with a looming deficit and the need to raise revenues from any possible available source. However, ASPA believes that the favorable treatment given to companies that invest in capital equipment is equally, and in fact increasingly, appropriate for investments in "human" capital. In the not too distant future the United States will be experiencing labor shortages. The Congress must be forward looking and seek out ways to encourage the private sector to train and develop workers to meet the country's needs in the face of growing international competition.

Recent studies funded by the U.S. Department of Labor recognize the need for both employer and employee incentives to provide and enroll in continuing education programs.

In the book Workforce 2000: Work and Workers for the 21st Century written by William Johnston, and published by the Hudson Institute with funding from the Department of Labor, six issues were highlighted which will require rethinking and revision in coming years. One of those six issues which must be addressed is the improvement of workers' education and skills.

Noting that "wealth has often been equated with factories, mines and production machinery within a nation's borders", the author goes on to state:

> "As the economies of developed nations move further into the post-industrial era, human capital plays an ever more important role in their progress. As the society becomes more complex, the amount of education and knowledge needed to make a productive contribution to the economy becomes greater. A century ago, a high school education was thought to be superfluous for factory workers

and a college degree was the mark of an academic or a lawyer. Between now and the year 2000, for the first time in history, a majority of all new jobs will require postsecondary education. Many professions will require nearly a decade of study following high school, and even the least skilled jobs will require a command of reading, computing, and thinking that was once necessary only for the professions."

"Education and training are the primary systems by which the human capital of a national is preserved and increased. The speed and efficiency with which these education systems transmit knowledge govern the rate at which human capital can be developed. Even more than such closely-watched indicators as the rate of investment in plant and equipment, human capital formation plays a direct role in how fast the economy can grow." Further, the book Worklife Visions written by social forecaster Jeffrey Hallett and published by ASPA, states that a fundamental "shift that will alter education and training activities is the emergence of the need for lifelong learning." Hallett goes on to state that "the pace of change has accelerated to the point where no particular skill or methodology has relevance for very long. This has profound implications. At its most basic level, it suggests that everyone we hire will have to be retrained three or four times during a normal employment period."

Clearly, the reinstitution of a effective and proven tax incentive which increases the speed and efficiency with which knowledge can be transmitted, represents good public policy. We therefore encourage the Committee and the Congress to act favorably on S. 39.

American Society for Training and Development

The American Society for Training and Development (ASTD) appreciates the opportunity to present its views on the tax exclusion for employer-provided educational assistance, (Section 127 of the Internal Revenue Code).

ASTD represents over 50,000 training and human resource development professionals nationwide with members concentrated primarily in Fortune 1000 companies. Our members are responsible for the training and retraining of the workforce from entry level youth to top management. Many of our members are also responsible for administering employer-provided educational assistance -- typically tuition aid -- programs. Consequently, ASTD is very familiar with the Internal Revenue Code Section 127 and how it is utilized.

Internal Revenue Code Section 127 provides that up to $5,250 annually in educational assistance provided to an employee by his or her employer may be excluded from gross income for tax purposes. Because Congress failed to extend the program last year, Section 127 expired on December 31, 1987. The American Society for Training and Development strongly urges Congress to retroactively extend Section 127.

Bills have been introduced in both the House and Senate to permanently extend Section 127. Congressman Guarini's bill, H.R. 1692, currently has 300 House co-sponsors. Senator Moynihan's bill, S. 39, has 39 Senate co-sponsors. Both bills continue the $5,250 cap and IRS reporting requirements which require employers to provide information about the cost, the number of eligible employees and the number of participants in their Section 127 programs.

For years, employers have provided assistance to their employees to further their education, upgrade their current skills or simply fulfill their intellectual interests. If the education provided by an employer was related to the employees' current job, it was not treated as taxable income. However, as more employers offered such financial assistance, employers' questions as to the impact that assistance had on the individual employee's income became cumbersome. The confusion, uncertainty and multiple interpretations of the IR Code and Treasury Department regulations on the withholding of taxes for tuition assistance was brought to Congress' attention. The confusion ranged from questions on general tax liability to how job-related educational assistance can be distinguished from non-job-related assistance - and why it mattered. Consequently, in 1979 Congress added Section 127 to the tax code, exempting all tuition aid from taxation as employee income.

Because it was a new provision added to the tax code, Congress granted a five-year authorization rather than a permanent extension so the issue could be reviewed and reconsidered. And considered and reviewed it has been -- for the last five years. The expiration at the end of 1987 represents the third time Section 127 has been allowed to expire. The two previous expirations, 1983 and 1985, were granted retroactive extensions in October of each of the years following the expiration.

Confusion about Tax Status of Educational Assistance

The uncertainty surrounding this particular provision creates confusion for both employers and employees alike:
1) Employers encounter burdensome amounts of paperwork because they do not know what to do -- if they withhold taxes and then Congress retroactively extends the provision, they must return the withheld taxes to their employees;
2) Employers face possible penalties if they do not withhold taxes and the law is not retroactively extended; and
3) Employees are faced with a disincentive to further their education (especially for the lower paid employee).

With Section 127's expiration, employers are currently legally bound to withhold taxes on educational assistance that is not related to an employee's present job. However, no guidance has been issued from IRS or the Treasury Department regarding this issue. Therefore, employers are handling the taxability of educational assistance in a wide variety of ways; consequently, "job-related" is being interpreted differently in almost every employer-based organization. Some companies are withholding on all employer-provided educational assistance; some companies are distinguishing between non-job-related and job-related education and withholding only on the non-job-related assistance; and still others are simply marking time to see if Congress will once again come along with a retroactive extension. As a result, IRS will have to deal with employers' confusion when the 1988 tax year is calculated and reported.

Participants Primarily Low to Middle Income Employees

Employee educational assistance participants span all income levels. And although a small percentage of upper income employees do utilize educational assistance programs, a majority of the participants are low and moderate income workers seeking to improve their skills and earning potential. In a survey ASTD conducted in 1985, it was found that 22% of the participants in educational assistance programs earn under $15,000 annually and 71% of the participants earn under $30,000. In the survey, 55% of the respondents said that educational assistance helps employees learn basic skills like reading and writing.
Moreover, taxation of non-job-related educational assistance disproportionately affects lower paid employees whose jobs are often more narrowly defined than those of upper level professionals and executives; therefore they have more difficulty relating any education to their current jobs. Section 127 allows these employees to take courses (without

being taxed) that may help them broaden their future job opportunities. On the other hand, the broader, higher level and higher paid job-holders can more easily justify education as job-related and, thus, are not nearly as negatively affected by the expiration of Section 127.

For example, with Section 127 "on the books", a mail room clerk who would like to continue his education or simply develop skills to enhance his future mobility within his firm, may take word processing courses at the local community college. Under Section 127, he would not be liable for taxation on the amount reimbursed by his employer. However, without Section 127, such a course which is not directly job-related, may be taxable to the individual employee. Yet, for someone holding a managerial position of any kind, almost all courses can be justified as relating to his job because of the broad scope of his current responsibilities. The scope of a person's work is very difficult to define and its varying definitions leads to different interpretations in almost every company. Employers support Section 127 because it pays off in workplace performance. When an employee learns new skills, the result is often a higher return on the investment for the employer through a more productive workforce. It demonstrates the employer's interest in the lifelong learning of their workforce. It also gives employees an opportunity to expand or fine-tune their interests, which often means developing a broader perspective in performing their jobs. Such long-term benefits of employee educational assistance should not be overlooked. Section 127 enhances employee job satisfaction and provides a higher return on investment for the IRS in additional taxes from employees who learn more advanced skills, thus making higher taxable wages.

Educational Assistance Contributes to Productivity

As previously stated, those who will be the hardest hit by taking away Section 127 are the lower level, lower paid employees -- the ones who have the most to benefit and will now have the least incentive to further their education and increase their skills. It is ironic that such a program could be allowed to die at a time when training is being hailed as one of the most important national policy priorities.

During a time when the national debate on competitiveness centers on the ability of American workers to continually upgrade their skills to keep pace with changing technology, the need for Section 127 is heightened. It is a critical tax incentive that promotes training and retraining for our workforce. Employee educational assistance helps to upgrade the abilities of the American workers -- at a low cost to the taxpayer. It contributes to national productivity and competitiveness in the world marketplace. By encouraging employees to acquire new knowledge and skills for coping with the changing workplace, employee educational assistance makes a significant contribution to American industry.

Employer-provided educational assistance is a time-tested and cost-effective means of upgrading skills of American workers -- an absolute necessity when addressing the issue of U.S. competitiveness. Workers can upgrade their skills, continue their education and maintain the skills necessary for the technological changes taking place in their current job: all without being penalized by the tax code.

Thank you.

STATEMENT OF RICHARD BERENDZEN
PRESIDENT
THE AMERICAN UNIVERSITY
WASHINGTON, D.C.

On behalf of The American University, its 12,000 students, 500 faculty members and 950 staff members, I urge the Committee to act favorably on S. 39 and permanently restore Section 127, the Employee Education Act, to the Internal Revenue Code, effective retroactive to its expiration last December 31.

The American University is a leading academic institution, offering a wide range of undergraduate and graduate degree programs through its four major divisions — arts and sciences, business administration, international service, and public affairs. The University — to attract and retain qualified personnel and students — has remitted tuition for students employed full-time in clerical as well as professional positions. The University is proud that hundreds of its employees have obtained undergraduate and graduate degrees through this program and the positive impact it has had on their lives.

Section 127, which has pemitted employees to receive, as a tax-free fringe benefit, tuition support has enable many low-paid and undereducated workers to return to school and to earn a degree that qualified them for better, higher paying jobs and a higher standard of living.

With repeal of Section 127, many students and employees of The American University and most other institutions of higher learning will be unable to continue their education if they must pay taxes on the value of tuition from their limited wages. For example, a course at The American University that an employee takes on a tuition remission basis will result in a reduction in take-home pay of between $73 to $200, depending on the employee's income, filing status, and other deductions. Although this additional tax might be offset by an increase in wages, ultimately an increase in tuition would be necessary to offset the wage increase. Thus, students, employees, and the University all are harmed with only a negligible increase in revenue for the government. Of particular importance to private colleges, this rule will cause students and employees to take employment with tuition remission programs with public rather than private schools where tuition costs, and consequently withholding taxes, will be less.

Education assistance is a good investment in out nation's future; it yields returns that cannot be measured fully by 5 year revenue projections of the Joint Committee on Taxation. On behalf of The American University, I urge you to recognize this benefit and reenact Section 127 of the Internal Revenue Code.

Association of American Publishers, Inc.
Washington, D.C.

In considering the effect of the tax system on education in the United States, the Committee should not limit itself to reviewing possible tax incentive devices to ease the burden of education costs on parents and students. It should also act to eliminate a tax disincentive to production of quality instructional materials that the Treasury Department insists was introduced by the uniform cost capitalization rules of the 1986 Tax Reform Act.

This attachment explains the R&D character of the work of publishers in developing instructional, professional, and reference materials, and outlines the legal background of the problem and explains why only legislative relief can solve it.

R&D EXPENDITURES BY PUBLISHERS

The activities of a book publisher in preparing instructional, reference, or professional materials involve work that qualifies as "research or experimental" ("R&D") by any reasonable standard. In general, the process begins with careful research into the need for a new or improved product, followed by preliminary testing and definition of pedagogical and substantive approaches and concepts. This phase features extensive review of the latest pedagogical data and analysis, as well as interacting with teachers, academics and school administrators. Thereafter, the publisher's staff, in collaboration with the author or team of authors selected to carry out the project, defines the general specifications for the product. Based on these specifications, the publisher and author team work together to create one or more prototypes of the new product.

These prototypes are then tested and evaluated by the publisher's staff, working in classroom settings with teachers and students and with experts in the field, to develop highly detailed specifications. These specifications function as blueprints for the authors in preparing the first full manuscript. The authors then prepare successive drafts, which are reviewed by the publisher's staff for conformity to the specifications, and subjected to further field testing and evaluations.

Throughout the process, the publisher is continually and closely involved in classroom testing and in expert evaluation to determine if the product will function properly in the intended educational setting. Based on this trial-and-error approach, the product is modified until a final version is ready to be prepared for printing and mass production. In some cases, particularly in the case of elementary and secondary school textbooks subject to a governmentally operated "adoption" procedure, the process of testing and modification continues even after the materials are initially prepared for printing and manufacture.

The process of developing instructional, reference, and professional material is characterized by heavy involvement of the publisher's staff, not merely in revising an author-submitted manuscript, but in conceptualizing the product, developing detailed plans, and working with potential users and substantive and instructional experts in testing and evaluating preliminary outlines and drafts. In response to these tests and evaluations, the product under development is continually modified and adjusted as the development process goes on.

In all instances, this preproduction development process for instructional, reference, and professional materials is not what is normally thought of as "editing." It is a radically more complex, sophisticated and intense process. It considers not only the order and organization of the words used, but the whole format for presenting the material, including the scope of the subject covered, the order of presenting subjects, the relation of graphics and illustrations to the educational objectives of the publication, and the effectiveness of particular methods of presenting the material. It embodies classroom field tests and expert evaluations of preliminary designs and prototypes that feed back into the process.

In many cases, the product resulting from these R&D efforts comprises several interrelated elements to be used in conjunction with each other. For example, in the case of elementary school instructional materials, the product developed by this process of research, experimentation and testing, with modifications based on results at earlier stages, is not a single textbook, but a whole system of teaching aids (such as filmstrips, overhead transparencies, demonstration materials, and computer software), teacher manuals and special teacher editions of the text, student workbooks, and testing materials.

The instructional publisher's systematic planning, testing, and evaluation throughout a product development process, feeding back into continual modifications of the emerging product to insure effective application of knowledge and techniques to a final product, is exactly analogous to the R&D process of other industries which apply technology and the results of experimentation to the development of new products.

There is no sound reason to deny publishers of instructional, reference, and professional materials the same tax treatment for R&D costs that manufacturers of other products enjoy. Indeed, the critical social importance of quality educational materials makes it especially appropriate to allow current deduction treatment in these cases.

LEGISLATIVE AND REGULATORY BACKGROUND

Since 1954 -- and, in practice, before that -- costs of research and development of new products have generally been allowed as a current deduction under section 174, even if those costs would otherwise have to be capitalized. In 1986, Congress adhered to the consistent practice of favoring new product development by a major statutory exception to the new uniform capitalization rule -- section 263A(c)(2) which specifically preserves the section 174 deduction for "research or experimental" expenditures ("R&D"). Consequently, most industries will continue to deduct costs of product R&D.

Barred from this relief,however, is the book publishing industry, where development costs -- Treasury insists -- are both excluded from the R&D deduction and subject to the full rigor of section 263A. Treasury's reading of the law is incorrect in both legal and policy terms.

Treasury Regulations § 1.174-2(a)(1)

Section 174 was included in the 1954 Code as originally enacted -- in the words of the reports in both Houses of Congress -- to "encourage taxpayers to carry on research and experimentation." H.R. Rep. No. 1337, 83d Cong. 2d Sess. 28 (1954); S. Rep. No. 1622, 83d Cong. 2d Sess. 33 (1954). Section 174 does not discriminate among different kinds of products, and there was no discussion of any such limitation when it was enacted.

At the outset, the regulations under section 174 interpret its scope very broadly to include "all ... costs incident to the development of ... a product." Treas. Reg. § 1.174-2(a)(1). In practice, the cases, published revenue rulings, and internal IRS pronouncements reflect this broad view and permit almost all industries to elect under section 174 to deduct their product development costs. In many cases, neither the products nor the process have the high degree of technical content manifested in the development of instructional, reference, and professional publications.

Treasury has, however, resisted application of section 174 deductions to any printed product, regardless of its character. Reg. § 1.174-2(a)(1) (originally adopted in 1957) has provided that "research or experimental expenditures" do not include "expenditures paid or incurred for research in connection with literary, historical, or similar projects." Although this could reasonably be read only as preventing amateur writers from attempting to deduct the costs of their "research hobbies," Treasury has read it as barring R&D treatment for any product embodied in print, even highly technical material or material developed on the basis of a process of analysis and experimentation that would clearly qualify as R&D in any other context.

The discrimination against book publishers is put into sharp focus when one recalls that in 1983 Treasury spokesmen recognized that R&D deductions are claimed by taxpayers in such varying business lines as fast food restaurants, baked goods, home building, banking, stock brokerage and the like. The discrimination against printed products produces startling anomalies. For example, instructional computer software -- commonly produced by book publishers, and marketed and inventoried side-by-side with books containing instruction in the same fields -- is given generous R&D deduction treatment by the IRS. From the point of view of equity, tax policy, or educational policy, there is new rationale basis for permitting R&D deductions for one type of intellectual product while denying it to another similar product.[1]

Revenue Ruling 73-395 and Congressional Criticism

Prior to 1973, most book publishers followed a consistent practice (for book and tax purposes) of deducting preproduction editorial and similar costs without disruption by the IRS. In 1973, however, the Internal Revenue Service issued Rev. Rul. 73-395, 1973-2 C.B. 87, expressing the IRS position that preproduction editorial costs must be capitalized as part of the cost of the book copyright and are not deductible under section 174. The ground for the ruling was the unexplained assertion that "costs incurred in the writing, editing, design and art work directly attributable to the development of the textbooks and visual aids do not constitute research and experimental expenditures under section 174."

This proposed treatment for the book publishing industry was strongly criticized as discriminatory and unjustified. Corrective legislation was promptly introduced to set aside the effect of the ruling. In 1974, for example, Congressman Dan Rostenkowski cosponsored legislation to this end and, in doing so, referred back to the 1954 enactment of section 174, stating:

> "There is no suggestion in these reports that section 174 would not apply to the costs of research and experimentation necessary to develop products of book publishers, such as textbooks, reference books, visual aids, and other teaching aids, merely because the taxpayer's business is publishing or because the teaching aid or other product of a publisher is in the form of a printed book rather than in the form of a mechanical device. Section 174 should not be interpreted to discriminate against book publishers in the business of developing or in improving reference books, teaching aids or other products."

Further criticizing IRS' interpretation of the Reg. § 1.174-2(a)(1) disqualification of "research in connection with literary, historical, or similar projects," Mr. Rostenkowski urged that "this regulatory exclusion should be confined to its proper scope, for example, to preclude the amateur novelist from deducting his essentially personal expenses in the guise of business research expenses."

Section 2119 Revenue Act of 1976

In 1976, Congress responded to these criticisms of Treasury's position by enacting section 2119 of the Revenue Act of 1976 to block IRS' use of Revenue Ruling 73-395 and to allow publishers to continue to treat their editorial and other "prepublication expenditures" "in the manner.... applied consistently by the taxpayer to such expenditures before the date or issuance of such revenue ruling." Congress further directed that any future regulations relating to this issue "shall apply only with respect to taxable years beginning after the date on which such regulations are issued."

No action has been taken by Treasury to date to comply with this Congressional direction. Consequently, the effect of the 1976 law was to maintain de facto parity between publishing and other industries.

Section 263A

This detailed and specific congressional directive concerning prepublication expenses of book publishers was never mentioned in the extensive legislative history of the uniform cost capitalization rules that became section 263A in the 1986 Act. No reference to section 2119 appears anywhere in the text or legislative history of the 1986 Tax Reform Act. No hearings were held on this issue, and no opportunity was given to the publishing industry to present its views.

However, Treasury's temporary and proposed section 263A regulations take the position that section 2119 of the 1976 Act was in essence repealed by section 263A, and that all book publisher's product development costs must be capitalized under section 263A and cannot be deducted under section 174. This position is inconsistent both with the 1986 legislation and with basic principles of statutory construction.

Repeal by implication, says the classic maxim of statutory interpretation, is generally disfavored. Further, as a matter of substance, a very general later law should not be viewed as repealing a highly specific earlier one.

Even if section 263A did override the 1976 provision, capitalization of the publishers' costs at issue is not necessarily required. For section 263A states that the new rules apply only to real property and "tangible" personal property. In turn, the latter term is statutorily defined as including "a film, sound recording, video tape, book, or similar property." As to the book publishing industry, this would appear to mean the costs of the actual tangible product -- platemaking, printing, as well as other production costs.

1986 Conference Report

The Conference Report repeats that "application of the uniform capitalization rules with respect to production activities is limited to tangible property." But in a last-minute footnote added to Conference Report (II-308), the term "tangible property" is defined to include:

> " ... films, sound recordings, video tapes, books, and other similar property embodying words, ideas, concepts, images, or sounds, by the creator thereof. Thus, for example, the uniform capitalization rules apply to the costs of producing a motion picture or researching and writing a book."

Despite this murky 1986 legislative background, the proposed section 263A regulations, purporting to find a clear congressional judgment in that somewhat opaque Conference Report footnote, declare that section 263A, as a new Code section, is not included within the coverage of section 2119 and that, in any case, section 263A repeals section 2119. The regulations, on that basis, deny section 174 treatment for, and flatly require capitalization of, all "prepublication expenditures incurred by publishers of books and other similar property, including payments made to authors of literary works, as well as costs incurred by such publishers in the writing, editing, compiling, illustrating, designing and development of books or similar property."

When this Treasury position -- and its discriminatory effect on the innovation and creativity in educational materials that are so important to the quality of American education -- was called to the attention of members of the tax-writing com ittees, a majority of both this Committee and of the House Ways and Means Committee wrote the Treasury Department to urge that

> "Treasury amend its regulations under section 174 ... to clarify that publishers' costs for research and development of instructional, professional, and reference materials are eligible for the [R&D] deduction."

By a letter of February 8, 1988, Dep. Sec. McPherson turned this request down. While expressing sympathy for the publishers' policy arguments, he concluded that present law bars Treasury from easing the problem by amending its regulations. He indicated at "a legislative proposal along those lines would ... be worthy of consideration," depending on its specifics.

The result of Treasury's spurning the appeal of members of this Committee and of Ways and Means and insisting on its strained and unfair interpretation of the 1986 statute is that the only course now open to publishers of instructional, professional, and reference materials is to seek corrective legislation, to clarify that section 174 provides them with equivalent product development deductions comparable to those given to other businesses.

PROPOSED CORRECTION

The AAP urges that the appropriate resolution of this issue -- from the point of view of the impact of taxes on education, as well as on simple equity grounds -- is to afford publishers of instructional, reference, and professional materials the same treatment for their R&D costs as is afforded other businesses. Such action would be fully consistent with the terms and purposes of the 1986 Act and would prevent the severe adverse impacts that would flow from Treasury's misreading of the 1986 Act as applied to publishers' R&D costs.

By this request, the book publishing industry is not asking for special treatment, but only for equal treatment with other industries. We are not asking for the creation of a special tax incentive for development of quality instructional materials, but only for the removal of a disincentive Treasury insists was created by the 1986 Act.

Under the correction we propose, section 174 would explicitly be declared applicable to research and development expenditures of a publisher of "instructional materials." Qualification as "instructional materials" would be expressly limited to materials prepared for publication with the principal purpose of use in systematic instructional activities in elementary, secondary, or vocational schools, or in post-secondary schools; as reference works or technical materials for use by persons in the conduct of their professions; or as instructional reference works, i.e, materials published for self-instructional activities in the liberal arts, the sciences, or similar disciplines and standard reference works such as encyclopedias, dictionaries, and thesauruses. Publications not coming within these definitions of "instructional materials" would not be covered.

Further, even for the limited category of publications covered, only those prepublication costs that qualify as R&D costs would be eligible. As explained above, for the publishing industry, those qualifying costs are the costs of identifying the need for a new or improved product, of gathering laboratory data related to it, of conceptualizing the product, of developing and field testing prototypes, of developing the manuscript, of designing and field testing the final layouts, of making content and design changes as a result of such field testing, and of pilot testing and adoption procedures. Not within the purview of section 174, but instead subject to capitalization, would be the following: Advance royalty payments to authors and costs of actual manufacture of the books or other products, including platemaking costs (material, typesetting, film making and labor), as well as production costs (paper, ink, binding, jackets and labor).

In sum, this committee's adoption of the proposed amendment would:

- Eliminate a disincentive to development of quality instructional materials,
- Correct an improper interpretation of the 1986 Act,
- Eliminate the unjustified discrimination produced by Treasury's interpretation,
- Foster innovation and creativity by educational book publishers,
- Support their efforts to improve and modernize teaching, reference, and professional materials, and
- Serve the public interest by strengthening sensible national educational policies and priorities.

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[1] In practice, more and more instructional, reference, and professional materials are appearing in both computer and print form, leading to the anomalous situation in which the costs of creating and developing a printed mathematics workbook, for example, are not eligible for the deduction, but the cost of developing a program for presenting the same information on a computer screen would be eligible.

Statement Of
Thomas F. Brady
Vice President
Baltimore Gas and Electric Company
For The
Senate Finance Committee Hearing
On Tax Incentives For Education

The Baltimore Gas and Electric Company (BG&E) urges the Committee to support Senator Daniel P. Moynihan's bill, S. 39, to restore Tax Code Section 127, which provides an income exclusion for employer sponsored educational assistance.

Without Section 127, the taxability of benefits received under an educational assistance program is determined by the nature of the courses provided. Revenue Ruling 76-352 provides that any program which includes courses that are not specifically job related, results in taxable income to all employees participating in the program. Under such a program, only those employees who meet the requirements of Treasury Regulation Section 1.162-5 are entitled to a tax deduction for the education expenses. This regulation generally provides that to be deductible, education must be job related and must not lead to qualification for a new trade or business.

In effect, the expiration of Section 127 creates an inequity that discriminates against lower income employees who can least afford to pay taxes on tuition assistance. These employees, tending to have narrowly defined job descriptions, have a difficult, if not impossible, time in demonstrating that they meet the specifications of the above Treasury regulation. Taxing educational assistance benefits may deter these lower level employees from enrolling in educational programs, thereby keeping them locked into poorer paying jobs.

Section 127 is an important tax incentive that helps assure that America's work force is well trained and competent. As a nuclear electric utility, BG&E believes such training is of vital importance. For example, the Company's educational assistance program is used to provide some employees with the opportunity to obtain college degrees in the field of nuclear science. In this way, the program enhances the skills of nuclear operators working in a complex environment. In addition, the Company's education program provides training for employees in many other important fields. Section 127 assures that employees do not suffer adverse tax consequences while receiving this education and training.

Allowing Section 127 to expire is contrary to the other tax incentives that serve to improve our country's edge in global economic competition, such as the research and experimentation credit. The need for such incentives is recognized in the President's budgetary proposal for fiscal year 1989, which recommends that a tax credit for research expenditures be permanently established. Because educated and well trained personnel are required in the performance of research and development activities, the restoration of Section 127 should also be part of a tax policy designed to enhance our Country's ability to compete in the world market.

My name is William R. Belisle. I have been interested and concerned about tax incentives for education for many years, both on a personal and an organizational level. On March 15, 1988 a hearing on this topic was held by the Senate Finance Committee, and this written statement is intended for inclusion in the record of that hearing.

Let me begin by saying that my own personal success is at least partially due to tax-free Employee Educational Assistance (EEA). Over the years, I have used corporate tuition refund programs to maintain my job knowledge and skills by gaining necessary education.

MY PERSONAL INVOLVEMENT WITH EEA

While employed as an engineer at AiResearch Manufacturing Company located in southern California, I used the corporate Educational Refund Program that company provided to improve my technical and management skills. As I started in my professional career, I had realized that the only way to "get ahead" was to stay ahead--educationally. At various times, I attended classes leading to a Master's Degree in Mechanical Engineering and to a Master's Degree in Business Administration; I did achieve both of those academic milestones.

But these were hard times financially as I strove to achieve these goals. The availability of tax-free educational assistance made these goals possible. Without EEA I may not have obtained the education, and it certainly would have taken a longer period of time. I also know it would have taken longer to afford that additional education if I had had to pay tax on it.

CORPORATE INVOLVEMENT WITH EEA

In 1979 I became the Training Administrator at the same organization. It is a aerospace company with over 6000 employees, and one of my duties was to administer the company's educational assistance.

Each year hundreds of employees used the valuable Tuition Refund Program to better themselves on the job. For the company to try to conduct the myriad training itself would have been an insurmountable task. But, employees used the educational assistance to maintain and improve their job knowledge through formal education, the same as I had.

I have talked with many of those employees, and I have asked about their use of the program. Because of cost, many individuals felt they would not have been able to continue their education without tuition aid, and some felt that they may not have been able to do so even if they had to pay only the tax.

Over the years countless employees in countless organizations have benefitted greatly from the tax-free status of EEA. Many of the disadvantaged classes have especially been helped. Women and minorities have been able to "break out" of their stereotyped and lower-level jobs. I, myself, know this to be fact due to the observations I made as the top training professional in the company.

Another important point to be made is that the company also was able to maintain its competitive "edge" by maintaining a high level of technical knowledge and skill. A high-tech aerospace company needs highly qualified employees in the technical areas; hiring employees away from other companies is a short-term answer that is not a final solution. An obvious disincentive is to require employees to obtain education that would benefit the organization, but which would financially penalize those same employees by having them pay tax on the education.

It is only with education that our country has been able to come to the forefront as one of the industrial giants of the world, and it is only with education that it will remain so. To require taxation of educational benefits will only weaken our entire system. This is another a short-term answer, but this time to national budgetary problems. To quote an old saying by Burton, this appears to be a policy of being, "Penny wise, pound foolish." What on the surface appears to be a way to save a few million dollars in hard currency over the next few years I feel will end up costing our country irreparable damage that will eventually add up to a loss of billions of dollars in brainpower to the U.S.

Over the last few years the process of "on again--off again" taxation of EEA has added a feeling of uncertainty to those who need a more solid base than most Americans. These are people who are trying their best to improve their own knowledge, while at the same time juggling their work and personal lives.

Let's add a measure of stability to their lives; let's not penalize them for improving their minds and their job productivity; LET'S MAKE TAX-FREE EDUCATION AVAILABLE TO AMERICA'S WORKFORCE--PERMANENTLY.

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STATEMENT OF
THE BURGER KING CORPORATION

Mr. Chairman and Members of the Committee, Burger King Corporation is pleased to submit this statement in support of S.39, legislation pending in the 100th Congress to make permanent the exclusion for employee educational assistance under Section 127 of the Internal Revenue Code.

The Company's support for this legislation emanates from a philosophical commitment to employer-assisted education, as well as from the Company's success in administering its own Section 127 educational assistance program. As an employer providing jobs, training, and direction each year to more than 50,000 hourly-paid employees nationwide, Burger King is keenly aware of the importance of education and training to the people who will shape America's future.

Treasury Opposition

The Treasury Department opposes S.39. The Department states that Section 127 "creates an inequitable distinction" between taxpayers and, in addition, has not principally benefited those most in need of assistance. The Department further estimates that the total revenue loss of reinstating Section 127 effective January 1, 1988 would be $275 million in Fiscal Year 1988 and approximately $400 million annually thereafter.[1/]

The Treasury Department's views should not be accepted as a basis for failing to reenact Section 127. Burger King believes that Section 127 should be made permanent, and, if modifications are needed to address the Department's concerns, the Section should be amended accordingly.

Section 127 does not create inequitable distinctions. It provides a rationale basis for encouraging a broad range of employers to help employees improve their skills and better themselves. To say that Section 127 creates or encourages "inequitable distinctions" fails to recognize the underlying Congressional purpose for its original enactment --- "to provide greater educational and economic opportunity to those who have had limited access in the past and who are least able to pay. . . ".2/ Moreover, in the Company's experience, Section 127 has, in fact, benefited those most in need. The Company also believes that the revenue impact may even be positive in the long term.

The Success of Section 127

In support of its position, the Treasury Department cites various 1984 reports compiled by the U.S. Department of Labor. However, the nation's economy has changed dramatically since 1984. The overwhelming impact of technological advancement since that time, and the clear and present danger to our country from intense international competition that is bearing down upon us today make looking to the past --- 1984 or any other time in our country's history --- questionable as a basis for evaluating the future benefits of pending education legislation.

The Company believes that the 1985 direct survey of 319 companies conducted by the American Society for Training and Development ("ASTD") provides a more reliable basis to evaluate S.39. Unlike the reports used by the Treasury Department, the survey specifically addressed Section 127. The findings of the survey comport with the Company's own experiences from 1985 to the present. The survey found that employee educational assistance:

- Is offered by a broad and diverse cross section of employers;
- Is utilized by employees at different compensation levels with the highest concentration in the low-to-middle income ranges;

- Helps laid-off workers to obtain new skills;
- Allows employers to offer cost-effective programs for upgrading skills of employees; and
- Encourages workers to keep up to date with new technological and industrial developments.

According to the ASTD report, a clear connection exists between employer-provided educational assistance on the one hand and an increase in productivity and improvement in basic educational skills on the other.

The Burger King Plan

As stated, the Company's own experience supports the ASTD findings and demonstrates that those most in need-- youth, minorities, and other low-income taxpayers -- are the principal beneficiaries.

In 1985, Burger King introduced its Section 127 Crew Educational Assistance Program ("CEAP") after conducting a pilot program in the Company's New York and Atlanta regions. CEAP was specifically designed for the nearly 50,000 hourly restaurant crew workers across the nation whose annual income is approximately $3,500. Management-level employees do not participate in the program. CEAP's stated purpose is to assist crew members to obtain post-secondary school academic or vocation education and training.

Ninety percent of crew members using their CEAP funds are attending college, while ten percent have chosen vocational education. Some CEAP participants go on to become hairdressers, while others study engineering and medicine. Still others return to Burger King to participate in the Company's Management Development Program, going on to become, for example, restaurant managers and Company accountants.

Burger King's experience with both its pilot program and the actual Crew Educational Assistance Program has reinforced the Company's support for employer-assisted education. The benefits are apparent. Employee turnover is reduced, and the Company recognizes real savings as hiring and training costs decrease and employee productivity rises.

Of special significance in the Burger King CEAP programs is the positive impact on those individuals who have traditionally had limited access to educational and economic opportunity -- young people and minorities. Our youth and minorities, unfortunately, have often been relegated to low-paying jobs with little prospect of advancement, and have been hit hardest by America's declining investment in its human resources. Because so many crew members in the fast-food service industry are young, minorities, and other classes of lower-income individuals, Burger King and other major companies in the industry are in a unique position to materially encourage and assist these employees to continue their education and become more productive. Clearly Section 127 should be an essential part of an overall national agenda for education, permitting the Company and other major employers to contribute in a meaningful way.

Revenue Impact

Although the Treasury Department estimates that the reinstatement of Code Section 127 will produce a negative revenue impact, the Company believes that the long-term effect of continuing employee educational assistance programs should be "revenue positive."

Existing data indicates that middle and lower level employees are the largest beneficiaries of employer-provided educational assistance: 72% of participants in educational assistance courses earn less than $30,000 per year, and 22% earn less than $15,000 per year. As a group, these individuals are low-bracket taxpayers, and accordingly, the income tax revenue loss should be small in the short term. This is particularly true in the case of the Company (and the fast-food service industry in general) because 75% of the labor force is under the age of 21.[3]

Most employees utilize Section 127 educational assistance benefits to learn basic literacy skills and to take courses at the undergraduate level to obtain an associates or bachelor's degree. Thus, Section 127 is principally helping less skilled and educated workers who will benefit the most from further education and training. Improved skills through education lead to upward economic mobility -- up the ladder to better jobs -- and commensurate higher salaries. Higher salaries, in turn, mean higher income taxes over the long term.

Finally, because the earning of educational benefits is often linked to continuous service requirements (as in the Company's plan), the government should actually collect more payroll tax (as distinguished from income tax) than it otherwise would had the employee terminated service. Employees who are given the opportunity to earn educational benefits through continued employment respond. They work longer, uninterrupted periods, contribute more to the employer through reduced turnover and greater productivity, and ultimately pay more into the social security system. The additional payroll tax collected through continuous employment should offset any possible loss of revenue from the income tax in the short term.

Conclusion

The Company's CEAP program and other private programs of which the Company is aware have worked effectively within the original purpose of Section 127, and accordingly, the Section should be made permanent. Further, the Department's concerns may be addressed through appropriate modifications, if necessary.

Employer-provided educational assistance under Section 127 plays an important role in the partnership between American industry and the American work force. Private industry can make a unique contribution to the continued education and training of American workers; American workers, in response, can bring this country to its highest economic and competitive potential. By keeping programs such as the Burger King Crew Educational Assistance Program in place through the reenactment of Section 127, the Congress will have demonstrated its commitment to making this partnership work.

Burger King Corporation is pleased to submit its views to the Senate Finance Committee and urges the Committee to act positively for employee educational assistance. The Company would be pleased to discuss further the comments made herein or any aspect of its previous submission to the Committee of October, 1987.

Respectfully submitted,
Burger King Corporation

1/ Statement of O. Donaldson Chapoton, Assistant Secretary (Tax Policy), Department of the Treasury before the Committee on Finance, United States Senate, on March 15, 1988, pp. 4-6.

2/ S.Rept. No. 1263, 95th Cong., 2d Sess. at 101.

3/ Survey conducted by American Society for Training and Development, May, 1985, on Employee Educational Assistance, See Table 6.

CENTERIOR ENERGY

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April 6, 1988

TO: The Senate Finance Committee

REGARDING: Tax Status of Employee Educational Assistance (Section 127)

The United States has developed a unique culture.

It would be difficult, if not impossible, to change that culture without significant personal trauma for millions of people.

Culture in organizations and institutions is just as important to people as that on a national scale.

Part of organizational culture in America is the deep rooted expectation of encouragement and commendation for employees who have interest in improving their educational level.

Thousands and thousands of companies encourage employees to avail themselves of the benefits of advancing their educational background. Although the dollars these companies have spent has been tax deductible, the government has indirectly gained money through higher taxable incomes of degree earners, and because tuition and other fees have found their way into the taxable areas of the economy through the educational institutions.

Abandoning this deductible status may be seen as closing a loophole, but I believe it will have a far reaching detrimental effect on all of us. I believe, for instance, that this action will result in the following manifestations:

- Lower employee (and family) morale, less productivity (now and ultimately), increased irritation and frustration leveled against companies and governments.

  Do you know that in some cases the monies we are required to withhold represent the total amount of an employees' bi-weekly paycheck?

- Lower overall levels of education in the country, less people going to schools beyond high school, less money coming into the schools, lower levels of income for professors and other teachers, fewer classrooms filled, fewer jobs for people in education and education related professions, the more prestigious research schools suffering the most since what money is spent will more often be spent in the less expensive teaching schools.

I have talked with and heard from Human Resource and Personnel executives from dozens of companies. To be sure, they are not unanimous in their thinking or reactions; but most ultimately come to the conclusion that the abandonment of the tax deductible status of educational assistance will hurt their companies and their country.

More specifically, I am very concerned about the impact of taxing educational assistance payments, on the 9,000 employees at my Company and its subsidiaries. For example, so far in the 1987-88 school year, we have had 705 employees take part in our Educational Assistance Program. The breakdown of those participants include 378 office clerical and technical employees, 59 union employees, 195 specialists/professionals, 20 scholastic awards students and 53 supervisors.

The scholastic awards students are high school graduates who have gone on to college and are sponsored by our company in a co-op program.

I take issue with Assistant Secretary of Treasury O. Donaldson Chapiton's testimony that Section 127 "unfairly provided, at a substantial revenue cost, special treatment to only certain employed individuals who frequently were higher paid professional and administrative personnel".

As you can see from the breakdown of the participants in our Educational Assistance Program, only 53 of the 705 employees were in supervisory positions. This certainly does not support the Assistant Secretary's suggestion that "higher paid professional and administrative personnel" are the main benefactors of the Educational Assistance Program. In fact, 65% of the participants at Centerior Energy are in the office-clerical/technicial, union and scholastic awards categories and I can't believe we are atypical in the business community.

Likewise, our experience does not support the Assistant Secretary's claim that there is a substantial revenue cost. Here at Centerior Energy, lower level employees who obtain college degrees are eligible for promotion into our specialist/professional job groups. Without college degrees, many of our office and union employees would remain in the lower paying jobs. With a degree they frequently receive promotions involving higher salaries. This translates directly into the payment of additional taxes at the federal, state and local levels.

For example, out of the 705 participants in our Educational Assistance Program, 661 are pursuing degrees. The majority in all probability will receive promotions, within a few years following graduation.

Further, this only reflects the current situation. Of our total of 9,000 employees, additional hundreds are in more satisfying and rewarding positions now because of the Educational Assistance Program.

Without the tax deductible status of educational assistance afforded by Section 127, employees will go on striving to improve themselves and companies will continue to encourage them to do so, but the harvest of educated Americans will be less abundant, our people will be less enlightened and our culture will change.

I, therefore, urge you to reinstate the tax deductible status of educational assistance. It is important to all of us.

Sincerely,

Roger C. Mills
Director
Human Resources

Chick-fil-A, Inc
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The present and future ability of the United States to compete in the global market place depends directly upon the education and training levels of our workforce. The United States should encourage all of its citizens who seek to improve their skill levels since an educated, trained and motivated citizenry is a fundamental requisite to restore economic integrity to the American balance of trade.

The restoration of Section 127 is essential to help Americans gain skills that can prevent America from regressing as the dominant economic force in the world. It is absolutely vital that Congressional zeal to reduce the budget deficit not claim such programs as employee educational assistance when the short term savings to the Treasury may ultimately reverse exponentially.

The Chick-fil-A scholarship program has provided in its eighteen year history funds to 4,331 employees for pursuit of higher education. Many of the recipients would not have matriculated and others would not have continued their studies without the financial aid provided by our scholarship program.

The table below presents a summary of key statistics of the Chick-fil-A scholarship program:

Year	Number of Scholarships	----Amounts Awarded---- This Year	----Amounts Awarded---- Cumulative
1970	1	$ 1,000.00	$ 1,000.00
1971	0	0.00	1,000.00
1972	0	0.00	1,000.00
1973	1	500.00	1,500.00
1974	8	8,000.00	9,500.00
1975	15	7,086.39	16,586.39
1976	43	45,244.11	61,830.50
1977	71	67,902.20	129,732.70
1978	73	70,989.76	200,722.46
1979	143	142,504.01	343,226.47
1980	228	226,903.06	570,129.53
1981	372	372,720.35	942,849.88
1982	399	402,897.67	1,345,747.55
1983	561	561,386.64	1,907,134.19
1984	547	545,509.03	2,452,643.22
1985	557	555,549.81	3,008,193.03
1986	575	575,200.00	3,583,393.03
1987	670	669,494.50	4,252,887.53
1988	67	67,000.00	4,319,887.53

The excerpts that follow are taken from letters received from some of the individuals who have received a Chick-fil-A scholarship.

- "If it weren't for this money I probably would not be attending college this year."

  Diane M. Banzing, Redford, VA

- "...for giving me the opportunity to earn my $1000 scholarship. The scholarship money will help me finish my last year at Lamar University which is a big help financially."

  Sara Henckel, Beaumont, TX

- "Mark would like to already be in college but unfortunately his parents are divorced and money is extremely tight for him and his mom. (A) Chick-fil-A scholarship would allow Mark to get that first start in college."

  Jim Workman, Chick-fil-A of Killeen Mall, Killeen, TX

- "The scholarship will enable me to finish my education."

  Sharon Heiman, Beaumont, TX.

- "I knew my goal was to go to college. The only thing ..stopping my decision was money. Thanks to you, you're ..helping me start a future I am determined to have."

  Nichole Nelson, Sioux City, IA.

- "Thank you for giving students like myself the chance ..to take their education further."

  Patricia Thrasher, Homestead, FL.

- "I too wish to express my appreciation upon receiving ..my scholarship. Striving for a college education is a ..goal that will be much easier to reach with that bit ..of financial help."

  Rebecca Ann King, Lufkin, TX.

- "My work effort at the Cordova Mall...taught me to be ..responsible, consistent and how to set and attain ..goals. It culminated in your generous scholarship."

  Paige W. Rosenau, Pensacola, FL.

- "It is nice to know that your organization goes beyond ..what they have to do for the employees and offers ..these scholarship awards."

  Wendell Wyrick, Knoxville, TN.

- "I'm in college now thanks to you. I would like to thank you for the scholarship, because it has helped ..me greatly."

  Reyton Chitty, Virginia Beach, VA.

- "I am presently a freshman at Furman University, and ..this scholarship will greatly aid the financial burden ..of attending a private university."

  Lara Gilmore, Greenville, SC.

- "I received the Chick-fil-A sholarship, and (there) was a great blessing and burden lifted from our shoulders."

  Britt Ratledge, Johnson City, TN.

- "I sincerely appreciate your interest in employees who ..aspire to a higher education and the assistance you ..give them...the money I receive from the scholarship ..will certainly help to offset the burden of my tuition ..and room and board."

  Chris Lorsung, Indianapolis, IN.

- "Thanks to your generosity (I) have the opportunity to ..get back to college. An opportunity I not only ..greatly appreciate, but one I will use to the best of ..my ability."

  Tim Dewan,-Indianapolis, IN.

- "...I am able to attend this college which would have ..been out of my reach were it not for your scholarship."

  Rocco J. DeSterano, Naples, FL

- "I think what Chick-fil-A is doing to help young people start college is wonderful. As a parent with ..two young men starting college at the same time I can ..really appreciate this help."

  Mrs. Norma Jean Moore, Tampa, FL.

These comments illustrate the impact of our scholarship on the lives of people who are striving to improve themselves and their country. If benefits such as these are taxable income to the recipients, the dilutive affect on our economic well being will be present for generations to come. The private sector should not have its incentives to improve the American workforce diminished when the cost of doing so will ultimately be borne by all Americans.

The restoration of Section 127 should be implemented as soon as it is practical.

CHICK-FIL-A, INC.

James B McCabe

James B. McCabe
Vice President, Finance

JBM:pg

COM/Energy

Commonwealth Energy System
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Telephone (617) 225-4000

April 11, 1988

I am writing to express my view of why employer-provided education tuition should not be taxable.

Commonwealth Energy System is a wholly owned public utility holding company based in Cambridge, Massachusetts. We have two thousand six hundred (2,600) employees living and working in central, eastern and southeastern Massachusetts. We have long been committed to providing all of our employees with job security and, opportunity for personal growth, whenever possible. An important facet of this commitment is promoting educational opportunities with a liberal educational aid plan.

Our plan became even more liberal in 1979 when we started to reimburse 100% for tuition, books and materials for courses related to the business. While we believed the plan was a success, we found that many employees who had the most to gain from the plan could not afford to pay the tuition in advance and wait to be reimbursed after they completed the course. So, in 1986, we changed the plan to advance the payment for tuition. The results were greater than we anticipated.

In 1985, one hundred and seventy (170) employees participated; in 1986 (when we changed the plan) three hundred and eighteen (318) employees participated. This represents an increase of 87%. In 1987 four hundred and seventeen (417) participated which represents another 31% increase. Now we fear that once again many employees will have to drop out of the plan because by advancing them the tuition, they must pay taxes on an inflated amount. This is an unusually harsh burden on many who are least able to pay. This burden of additional taxes is also counterproductive if we are to prepare employees for retraining in an ever changing workplace.

Many of the types of courses taken are to advance within the company. We encourage this type of initiative as the ever increasing technological advances, in many instances, will eliminate jobs. For instance, new technology in meter reading will eventually eliminate this position. We are in the process of incorporating new software which will eliminate the need for data entry operators (keypunch). The new software will lessen the need for programmers as users will have the capability to manipulate the data themselves. With virtually a terminal on every desk and voice mail capabilities on every telephone, the need for secretaries (as we know them) will change. New titles such as administrative coordinator or administrative assistant are already replacing the secretary title and their duties have shifted from typing and shorthand to those requiring management skills. As jobs are eliminated, new skills are required to keep our employees in the workforce. They must attain these skills through education.

Traditionally, the public utility industry has difficulty in recruiting electrical and power plant engineers. We must, therefore, encourage employees to pursue education unique to the industry. However, this will become more difficult if the employee is taxed and has to reach into his/her earnings to make up the difference for the tuition payment.

Our company, whenever possible, fills positions from within the organization. To prepare oneself to qualify for promotions, education, coupled with experience, is an important element. A person shows initiative by attending an institution of higher education or a technical school. Education is a factor that is heavily weighed for successful job bidding. Taxing education stifles initiative because many people who wish to advance within the company cannot afford the tax burden imposed on them.

Our company is also committed to an affirmative action program, whereby, we encourage the promotion of qualified minorities and females. In order to become qualified, an important avenue is education. We fear the tax burden will become a significant roadblock.

Many employees, before entering the workforce, cannot afford higher education. They look for companies that offer assistance in developing their careers. The company benefits because we are able to develop our own managers and technical experts. These people have worked their way through the ranks thereby having more experience in the industry resulting in a stronger company. Once again, only those who have the resources before joining an organization will be educated.

We are all aware that additional revenue is required to pay off the national debt. If we look at the supply side economics of the issue, as people advance in the company their salaries increase and they pay more taxes. Therefore, the untaxed education will ultimately supply more revenue than taxing up front.

To compound the problem, the burden of job relatedness is on the employee. Most employees do not have the resources to face the IRS individually. Many employees will require a tax consultant--another added expense. The IRS rulings are complicated enough for tax accountants, let alone the average employee. Also, the problem of over/under withholding further complicates the issue.

Responsible government should promote education for everyone and it should be made tax free permanently.

Respectfully submitted,

Christine E. Conrad

Christine E. Conrad
Sr. Management Training Specialist

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March 18, 1988

TO: The Committee on Finance
The United States Senate
205 Dirksen Building
Washington, D.C. 20510

FROM: Dr. Walter B. Waetjen
President, Cleveland State University
Cleveland, Ohio 44115

SUBJECT: Written Statement in Favor of S.39 to Reinstate Section 127 of the Internal Revenue Code

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As president of Cleveland State University, I submit this written statement in support of S.39, legislation to reinstate Section 127 of the Internal Revenue Code.

Section 127 was allowed to expire December 31, 1987 due to Congressional concern that the tax revenues are a necessary component in the budget deficit reduction agreement forged with the White House. While the elimination of this exclusion from gross income could generate considerable tax revenues, it is important to consider the impact doing away with the exclusion will have on businesses, employees, and ultimately those very same tax revenues.

Section 127 helped make it possible for companies and businesses to offer educational assistance to their employees in order to improve job performance, train them for new jobs, and to promote career advancement. If Congress chooses not to reinstate this exclusion, programs in Continuing Education, Graduate Studies, and Staff Development will be jeopardized. Companies and businesses that in the past offered employees educational assistance, will experience a declining interest in these programs because employees will have to pay taxes on any assistance they receive.

There may be employee fringe benefits on which income tax exemptions are questionable. However, the exclusion from gross income allowed under Section 127 for employer-paid employee educational assistance has been one of the few that leads directly to improved job performance, and career advancement opportunities for the employee. This in turn leads to greater productivity, and higher paying jobs from which additional tax revenues are derived. In essence, Section 127 as an income tax exclusion does not hurt the economy or the federal budget, rather it has helped to nurture it.

In addition to the sound public policy and economic development reasons behind the Section 127 exclusion, it is also important to note the extreme administrative burden that elimination of the exclusion has caused universities, and businesses throughout the country.

For example, Cleveland State University must now withhold additional federal taxes from the checks of those employees and graduate assistants who have received staff development or fee remission benefits for graduate professional courses. This process has been extremely cumbersome due to the amount of time it takes to identify all of those individuals. Also, because students may add or drop courses until well into the term, our registrar will have to wait until the final add/drop date has passed during each term before being able to compile an accurate list of those students receiving the above benefits. The University has also had to undertake, at some expense, notification of all those employees, explaining to them that what in the past was excludable from their gross income, is now a non-cash fringe benefit subject to the federal withholding tax. Finally, the additional withholding out of those employees' paychecks has to be computed manually, as opposed to by computer, which again is costly, and time-consuming.

The loss of the Section 127 exclusion has not only been an administrative inconvenience, but it is a tremendous economic loss to all those employees who in the past have enjoyed the tax-free benefit of employer-paid employee educational assistance. Should these programs start to be phased out due to decreased employee participation, the loss of the Section 127 exclusion will undoubtedly result in a marked decline in tax revenues as well.

For all of the foregoing reasons, I urge your support of S.39 to reinstate the Section 127 exclusion. On behalf of Cleveland State University, I would like to thank the members of this esteemed legislative committee for giving this matter the time and consideration it so deserves.

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Comments of Cray Research, Inc.

Cray Research, Inc. appreciates the opportunity to submit comments regarding the issue of Employee Educational Assistance (Section 127 of the IRS Code). The mission of Cray Research is to design, manufacture, market, and support the most powerful computer systems available. These computer systems are better known as supercomputers. Today, Cray Research supercomputers account for approximately two-thirds of the worldwide installed base of these high-performance systems. The company employs over 4300 people and operates manufacturing and development facilities in Chippewa Falls and Rice Lake, Wisconsin and in the Minneapolis, Minnesota areas.

We are writing to strongly urge you to support the extension of Internal Revenue Code Section 127 relating to employer-provided assistance tax provisions, which permit an employee to exclude from gross income educational assistance provided by his or her employer, expired December 31, 1987.

This is a great concern to us at Cray Research for many reasons:

1. Competition in the supercomputer industry, especially with the increasing foreign competition, requires that our employees be as highly trained as possible in areas that go beyond what is actually required for a special job. As we push into new technological frontiers, employees are finding themselves in situations no one has ever been in before. Employees find themselves having to expand their skills beyond their job by taking initiatives to "get the job done" however they can. This frequently means taking additional courses. We encourage our employees to get appropriate training in order to be ready as new technologies emerge and current job skills become obsolete. This is especially critical today as we will be using totally new technology in the very near future and employees must be retrained fast in order to use the new technologies, and in order to keep themselves employed!

2. We strongly encourage our employees to "broaden their skills" as there are fewer and fewer management positions available. "Up the Corporate Ladder" gets pretty steep and there are simply not enough promotional opportunities for all who would like them. Thus, we offer educational assistance to employees to add more depth and breadth to their current jobs which offers them more job satisfaction as well.

3. Most of our employees who received tuition assistance work full-time and attend school in the evening also have families. This puts a very heavy burden of time on the employee as they become spread so thin. The additional pressure of having to pay taxes on their tuition, we feel, is burdensome and not supportive of individuals who are trying to manage jobs, families and school.

4. Additionally, high tech companies such as Cray Research need employees who can stay absolutely current with their technological specialty. The country needs this as well in order to maintain our position on the global market place.

5. We need employees who have drive and initiative. Taking on additional education not only helps the individual grow, but gives the investment back to the organization and the country. We desperately need that to maintain leadership positions in the global marketplace.

Again, we urge you to extend Section 127, believe it would be in the best national interest as well.

Thank you very much.

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COMMUNICATIONS WORKERS OF AMERICA

The Communications Workers of America represents more than 700,000 workers in telecommunications, government, health services, printing and publishing. As a union created by technological development, CWA has long recognized the need for continual retraining and skills upgrading to help our members use new technology. Our goal is to make CWA the education-driven union.

In 1986, when CWA negotiated with AT&T and the Bell companies we took major steps forward toward that goal. We negotiated for approximately $71 million worth of training and educational benefits for our members. In addition to those funds, many of the companies where our members work provide tuition reimbursement for college courses taken on the employee's own time.

Today, these hard-won educational benefits are threatened by Congress' short-sighted failure to approve S. 39 the Employee Educational Assistance Act of 1987.

As American workers strive to compete in world markets, they require broader skills than in the past. New technologies require more theoretical knowledge as well as hands-on applications. Recognizing this need, CWA has fought for ever-wider educational opportunities for our members. We have won training in broad, transferable skills that goes beyond the narrow, job-specific training provided by our employers.

Under current law, these educational programs are subject to taxation. This will cause administrative nightmares and could bring a total halt to the programs.

Until the tax exemption is restored, all of CWA's negotiated educational programs will remain in a state of uncertainty. For example, CWA and Mountain Bell agreed to spend $7.6 million over three years for a broad program of career counseling and training. Administered by the Council for Adult and Experiential

Learning (CAEL), this program is open to all 28,000 Mountain Bell employees.

The program provides career counseling both through company counseling centers and colleges and universities. Once an employee has completed a career plan, he or she is eligible for direct prepayment of tuition to schools and colleges for courses related to the plan.

After a year of operation, the CWA Mountain Bell program has been quite successful, with approximately 13 percent of the employees completing career plans and 11 percent of employees enrolled in courses. However, unless Section 127 of the Internal Revenue Code is restored, the program could be in jeopardy. Attorneys for U.S. WEST, the parent company of Mountain Bell, have determined that the progam is an educational benefit subject to taxation under the current law. Although the company is not yet withholding this tax from employee paycheck, it plans to begin doing so by this summer.

When CWA members find that their participation in this educational program results in additional withholding from their paychecks, their current enthusiasm for additional training may disappear. Our union's hard work in negotiating for the program and promoting it to our members may go by the wayside, along with the benefits of a stable and well-trained work force.

During Senate Finance Committee hearings in 1983, when Section 127 of the Internal Revenue Code expired, CWA made two points which are more true today than ever. First, we noted that CWA's training programs are aimed not merely at reinforcing current skills, but at developing the new skills required for future employment. This was one of the main goals we achieved at the bargaining table in 1986 -- to win employer funding for broad courses which would prepare our members for new jobs outside as well as within the telephone industry. Yet, with the expiration of Section 127, these are exactly the kinds of training which are now taxable. One of our largest employers, AT&T, has notified employees that they will be responsible for demonstrating that any educational benefits they receive are strictly job-related. All tuition benefits will be reported to the IRS, and if the employee cannot prove the courses were job related, he or she will have to pay tax on the value of the tuition. The unfortunate irony is that this is more difficult to prove for our members than for higher management, even though our members need better access to training, advancement and financial support.

Second, we noted that union-won educational programs benefit women, minorities, and other workers who have fewer opportunities for company-provided training. Studies by the American Society for Training and Development have shown that the vast majority of employer-provided training goes to managers, men and whites. In other words, those who are already most highly educated get more educational benefits at work.

CWA's newly-won training programs are countering this trend by providing off hours education to all workers. In the successful Mountain Bell program described above, 70 percent of the participants are women, with an average age in the late 30's, mostly married with minor children. 80 percent of the participants are non-management. But this unique opportunity for enhanced education will be less attractive if Mountain Bell begins withholding taxes on the career counselling and tuition payments.

Time is of the essence. Thousands of CWA members across the country are enrolled in career counselling and college courses. Most of our employers are not yet withholding taxes on these benefits, but many plan to start soon. This discouraging action will reduce participation at a time when CWA is making every effort to encourage our members to broaden their education.

Congress is rightly concerned abut reducing the Federal deficit. However, the approach of taxing education has the potential to reduce worker productivity and America's international competitiveness. The end result will be a higher foreign trade deficit. America's standing abroad depends on the skills and knowledge of its workers. Congress should act now to restore the tax exemption for educational benefits.

DIGITAL EQUIPMENT CORPORATION

Digital Equipment Corporation strongly supports the reinstatement of Internal Revenue Code Section 127 which relates to employer-provided educational assistance.

As a company who values the development of its employees, Digital encourages employees to continue their development in many ways one of which is through continuing education.

In the past, we have been able to do this through our Education Assistance Policy which creates a partnership between the employee and Digital. The employee contributes his or her time and energy through taking educational courses and Digital contributes the necessary financial resources needed. This resulted in a positive outcome for the employee, the company and the country.

For the employees, it allowed them to improve their potential for job promotion, and to improve their chances for career growth. For the company, it takes a valuable human resource and makes him and her more valuable. And, for the country, it helps to move the economy forward and supports the American tradition that through self-improvement a better life can be available for every individual.

With the recent expiration of IRS Code Section 127, a new message is being sent to the American people, and to American companies that will eventually have a negative impact on our economy. A country that does not value education cannot maintain a leading edge in today's global economy. Valuing education means making a financial commitment, not merely saying that we value education. Currently our country's industries spend on training and education the equivalent to all public education costs. We have for too long, sat on the sidelines as our technological, productivity and management edges have been eroded by the combination of a complacent American Government and recent and continuing heavy investments in education by the governments of our foreign competitors. The world used to look to America as the leader in technology, productivity and management practices. All too often, we now find ourselves looking to other countries for new and innovative approaches to managing our industrial base.

As a high technology firm we are more sensitive to the changing technology required to be competitive with other nations. An engineer's knowledge-base is commonly thought to be obsolete within five years of completing his or her degree. Without constant updating we diminish the talents of our most valuable resource - our people!

With the permanent reinstatement of IRS Code Section 127, the government has an opportunity to renew the partnership with industry. It can offer a helping hand to Digital, and other American corporations to continue to lead the computer industry and not be relegated to a subordinate position of being reliant on derivative technology from foreign competitors.

One of the reasons that Digital has never had to have a reduction in our workforce is because of our strong commitment to the continued development of our employees. With the expiration of IRS Code Section 127 this past December, many of our employees were unable to continue their educational pursuits because of the financial hardship the law imposed. If this were to continue for any length of time, there is no doubt that it would have an adverse impact on our ability to grow our people.

The present law is regressive. Those effected include those employees who have yet to reach their full potentials. By penalizing them for trying to improve themselves we create a disincentive to those in the lower levels of corporations and force companies to hire from the outside rather than promote from within.

Originally, the institution of IRS Code Section 127 was to demonstrate support for people trying to improve their position in life and support for America to keep its competitive advantage. When the country withdrew from this partnership it sent a message to the nation that a relatively small short-term economic advantage was worth more to the country than long-term economic growth.

Digital Equipment Corporation joins with the rest of Corporate America in urging you to take this opportunity to demonstrate your support for the individual employee striving to improve himself and herself and your support for maintaining America's leadership position in the computer industry through the reinstatement of IRS Code Section 127.

THE EMORY CLINIC
1365 Clifton Road, N.E. Atlanta, Georgia 30322 Telephone (404) 321-0111

April 11, 1988

Senator Lloyd Bentsen, Chairman
Committee on Finance
205 Dirksen Building
Washington, D.C. 20510

Dear Senator Bentsen:

It was a pleasure to attend the Finance Committee's March 15, 1988 hearing on tax incentives for education. Those of us with roots in Atascosa, Bexar and McMullen Counties continue to be proud of your leadership--especially in education and health matters.

The restoration of Section 127 with S.39 has a distinct and significant impact on healthcare costs. It provides incentive and financial support for thousands of healthcare employees who continually prepare themselves to deliver more highly skilled care. Section 127 is an effective way of combatting manpower shortages caused by the need for such skills. It can, for example, lessen the impending nursing shortage by encouraging Licensed Practical Nurses to work for advancement to Registered Nurse.

I have applied Senator Ribicoff's analysis of S.39's revenue impact to Georgia hospitals' increasing articulation of Licensed Practical Nurses into Registered Nurse positions with educational assistance. My result is the same as Senator Ribicoff's: a revenue increase rather than loss. Assuming it takes two years to complete an Associate Degree in Nursing and that individual income tax rates are unchanged, the newly promoted Registered Nurse would pay (base on Georgia's average wages) $2,234 more in taxes for his or her first two years of practice. The revenue that would have been lost to Section 127 (based on Georgia hospitals' average plan benefits) would be only $340!

Thank you again, personally and on behalf of the American Society for Healthcare Human Resource Administration's 2,600 members, for your continued support of cost-effective government and for your committee's sensitivity to critical public need.

Very truly yours,

Robert Stephen Peel
Chair, Legislative and Labor Committee
American Society for Healthcare Human Resources Administration

EMPLOYEE EDUCATIONAL ASSISTANCE

Who Pays
Who Benefits

AMERICAN SOCIETY FOR
TRAINING AND DEVELOPMENT
1630 Duke Street
Box 1443
Alexandria, VA 22313

A report on a survey of 319 employers conducted by the
American Society for Training and Development
May 1985

INTRODUCTION

Employee Educational Assistance provisions, added to the Internal Revenue Code in 1978 (Section 127), allow employees to receive educational aid from employers without it being considered personal income. This education provision is due to expire December 31, 1985. In order to gather data on educational assistance use, and to aid in consideration of the extension, the American Society for Training and Development initiated a study of employer-provided educational assistance in the Winter of 1984.

The study was conducted on behalf of the 50,000 employer-based members of the American Society for Training and Development. Motorola, Inc. chaired an ASTD task force on educational assistance that led to the development of the survey instrument. ASTD Government Affairs Director Dorothy Walsh supervised the study. The survey was mailed to 1,000 private and public employers in late February. At the March 29 cutoff date, 319 employers responded. The results were tabulated in April.

The study, one of the largest conducted on educational assistance, includes data from a broad cross section of industries and employers. Responding employers include about six percent of today's labor force. Responses ranged from organizations with 43 employees to organizations with more than 100,000 employees.

The survey results show that educational assistance (typically tuition aid) is a small but important part of work place training and retraining. It is especially significant for upgrading employees, creating incentives for upward mobility, and providing remediation and basic skills training.

Findings from the survey include:
☐ 97% of all respondents have educational assistance plans.
☐ 87% of respondents with less than 500 employees have educational assistance plans.
☐ 72% of participants in educational assistance courses earn less than $30,000 per year.
☐ 96% of respondents said educational assistance was used for improving skills on-the-job.
☐ The highest participation rate (14%) was found in organizations with less than 500 employees.
☐ 54.8% of respondents said educational assistance helps employees learn basic skills like reading and writing.
☐ 91% of respondents cited the local community college as a provider of educational assistance courses.

The survey also found that employers are complying with the requirements of Section 127. For example, 97% post announcements, and many employers print materials or brochures on educational assistance. 100% responded that other taxable benefits or compensation is not reduced for those employees receiving educational assistance. The law specifically states that educational assistance programs cannot discriminate in favor of employees who are officers, owners or highly-compensated. Our survey data shows that in every case, employers offer educational assistance to a broad cross section of employees with the highest participation rates in the low-to middle-salary levels.

We submit these findings as evidence of the value of educational assistance to participants and in the interest of maintaining the nation's competitive advantage.

Without Section 127, employers will be forced to go back to confusing, vague and discriminatory pre-1979 regulations for educational assistance. Employers would either have to withhold taxes on all educational assistance to employees or determine, on an individual basis, whether each course an employee takes is "related" to present job responsibilities. The inevitable result would be to discourage employers from providing educational assistance.

—Curtis E. Plott
Executive Vice President,
American Society for
Training and Development

Sample Educational Assistance Plans:

❝The company views your continuing formal education as an essential element in your life-long learning. Employees need to continue the learning process in order to keep up with the rapid rate of technological change.❞
—Metals company

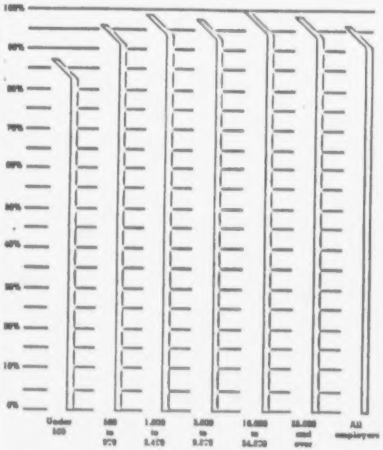
❝It is the company's intent to provide educational opportunities to all eligible employees, to increase their effectiveness on the job and improve their potential. This lessens the need for seeking talent on the outside to meet the needs of the company and reduces the possibility of job obsolescence of employees.❞
—Electronics company

❝It is our policy to encourage the self-development of full-time, regular employees. Whenever such development will improve the employee's effectiveness and value on the job and/or will help prepare the employee for positions of greater responsibility within the company, we're prepared to absorb part of the cost.❞
—Small manufacturer

What is Employee Educational Assistance and Who Offers It?

Employee educational assistance (e.g. "tuition aid") is the practice or program of payment, by an employer, of expenses incurred by or on behalf of an employee for courses to benefit the employee.

Firms offering educational assistance by size, in terms of number of employees



Source: Table 2

“*Every full-time employee is eligible to participate. People who have been with the company less than 90 days may participate only at the discretion of the plant manager.*”
—Illinois manufacturer

“*Our police labor agreement allows $1,000 for educational expenses for uniformed officers. All other employees are eligible, as required for their jobs.*”
—Pennsylvania city government

“*Full-time employees must have been in the employ of the hospital for at least six continuous months prior to the beginning of the course. Part-time employees who have completed five years of service and have been scheduled for 20 hours or more per week are eligible for a total of one-half the reimbursement amount of full-time employees.*”
—Medical center

Who is Eligible for Educational Assistance?

Percent of all employees eligible for educational assistance by salary levels

Salary level	**Percent eligible**
Under $15,000	94.2%
$15,000-29,999	96.8
$30,000-49,999	98.2
$50,000 and over	98.1
Not specified	93.4
Total for all employees	96.6%

Source: Table 3

(NOTE: In some cases, new employees are not eligible until they have been with the employer for some months.)

Publicity given educational assistance program

Question: Do you provide employees with information about your program through postings, etc.?

Answer: Yes 97%
No 3%

Question: Do you publish materials on your program?

Answer: Yes 75%
No 25%

(NOTE: Some of those replying "no" include information on their educational assistance program in general brochures.)

Source: Table 4

Who Participates in Educational Assistance?

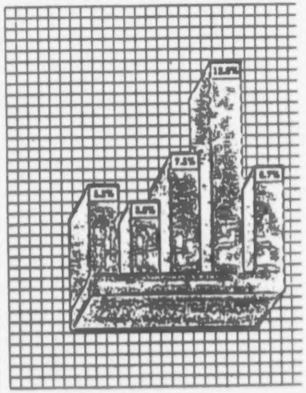
“*At my age, going back to school was hard. I didn't know a thing about electronics. I think the future jobs are in the electronics area. In addition to tuition help, employees who've been laid off and not receiving UI because of full-time school, are eligible to receive a training allowance equal to half the employee's normal weekly pay.*”
—Laid-off female employee receiving educational assistance

“*Former employees on layoff, who have six months' service, will be able to obtain tuition aid up to $1,200 per year for approved courses. Former employees on layoff will be eligible to receive a training allowance of 50% of weekly pay for a minimum of eight weeks while attending.*”
—Large midwest manufacturer

“*The job-related distinction often seems both ambiguous and restrictive. . . If a person with little or no work experience is employed in an entry-level position, and receives education from his employer to advance to a job requiring some greater skills, the value of that education may be taxable. This discourages self-improvement.*”
—Joint Committee on Taxation Revenue Act of 1978

“*Taking this class will allow me to graduate with an Associates Degree, upgrading my position from LPN to RN.*”
—Hospital employee

Rate at Which Eligible Employees Participate in Educational Assistance by Salary Level



Source: Table 5

“*If we did not have a tuition reimbursement plan, many/most of our hourly and office employees would not take advantage of training offered by area colleges.*”
—California manufacturer

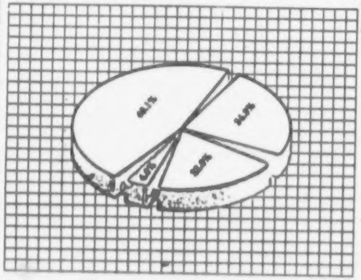
“*Tuition aid is particularly valuable for our lower-income employees, who would not otherwise pursue further education.*”
—Tire manufacturer

“*Educational assistance also aids our employees who are on layoff.*”
—Electronics firm

“*Employer-provided educational assistance provides an opportunity for minorities, low-income and first generation employees to gain formal academic credentials, which impact on their mobility in the work place and their standing in the community. Continuing and lifelong learning, through formal academic endeavors, is a sure way to help prevent obsolescence.*”
—New England insurance company

“*Both the city and its employees will benefit if the work force is properly trained. Continuous job and career-related education is encouraged.*”
—City government

Percent of total participants by salary level



Salary levels:
- ☐ $15,000 and under—22.0%
- ☐ 15,000 to 29,999—49.1%
- ☐ 30,000 to 49,999—24.3%
- ▣ 50,000 and over—4.6%

Source: Table 6

Percent of employees participating in educational assistance by size of organizations

Number of employees	Percent participating
Less than 500	14.4%
500-999	14.0
1,000-2,999	8.1
3,000-9,999	8.7
10,000-24,999	5.3
25,000 and over	5.0
Average for all organizations	5.6%

Source: Table 7

“*Among our students taking courses through educational assistance, 79 percent said their companies paid for all costs. Thirteen percent received three-fourths, 7 percent received half, and 1 percent a fourth of the costs.*”
—Eastern community college

“*Among our participating employees, many take more than one course a year. Employees earning over $35,000 are ineligible for educational assistance.*”
—Medium-sized employer

“*The company will reimburse qualified employees 90 percent of the cost of tuition and certain fees up to $900 each fiscal year.*”
—Eastern county government

“*The company will pay the education institution directly for approved courses. This payment method greatly reduces the financial burden on the employee.*”
—Hospital

“*The company will reimburse registration fees and tuition up to $2,500 per year.*”
—A bank

“*The course of study you select must be one that has relevance to your current or projected career within the firm.*”
—Illinois firm

How Much do Employers Spend on Educational Assistance Activities?

Expenditures by Size of Employing Organization

Number of employees	Average expenditures
Under 500	$ 18,121
500-999	46,538
1,000-2,999	60,984
3,000-9,999	631,807
10,000-24,999	434,969
25,000 plus	2,123,764
Average for all organizations	$ 624,833

Source: Table 9

Impact on other programs

Question: If one of your employees receives educational assistance, will this reduce any taxable benefit or compensation (e.g., wages) the employee is otherwise entitled to receive?

Responses:	
No	100%
Yes	. 0

Question: Do you provide educational assistance courses in-house that are not intended to improve employee performance on the job?

Only 32 of the 319 respondents said they offered any educational assistance programs in-house. These courses represent about 8.2% of their total educational assistance plan (average was 5%).

When courses are offered in-house, they tend to be remedial and job-related. Examples cited included remedial education, arithmetic, literacy and other basic-skills classes, English as a second language and business courses.

What courses do employees take?

“It is not the company's intent to imburse an employee for pursuing a preplanned college education.”
Medium size firm

“Courses must be of an educational r technical nature and related to the mployee's present job duties or those to which he/she will be assigned in the foreseeable future as determined by his/her manager.”
—Entertainment company

“Among our students taking courses with help from their employers, these are the most opular: computer science, electrical echnician, business management, mechanical technician, accounting, civil engineering technician.”
—Eastern community college

“This plan does not cover short minars and noncredit courses, hobbies or sports classes, unless part of an approved degree program.”
—West Coast Manufacturer

“If you start an approved course nd are subsequently laid off, you will still be reimbursed for successfully completing the course.”
—Manufacturer

Educational Assistance stimulates productivity:

☐ 97.3% of all respondents said employees receiving educational assistance take some courses to improve their performance in their current jobs.
☐ 86.2% of all respondents said at least one-half of the courses directly improve employees' skills for their jobs.

Educational Assistance helps upward mobility of employees:
☐ 52.4% of all respondents said at least ¼ of all employees receiving educational aid take courses in basic educational skills. The category "basic skills" (e.g., reading, writing, math, GED, etc.) was cited by 54.8% of all respondents.
☐ Between 25% and 49% of employees participating in educational assistance take courses that could lead to a bachelor's degree, and thus a promotion, higher wages or expanded job responsibilities.

Educational Assistance encourages collaboration between employers and local community colleges:
☐ 42.7% of all respondents said at least ½ of all their employees receiving educational assistance take courses at local community or junior colleges.
☐ The category "community or junior college" was cited by 91.7% of all respondents. Employees take a variety of courses including word processing, computer literacy, business English or technical, vocational classes.

Educational Assistance is not used extensively for graduate school:
☐ 76% of all respondents said none of their employees receiving educational assistance take courses that could lead to a law degree. In all cases, of those respondents who allow employees to take legal courses, less than ¼ of all participating employees take legal courses.
☐ 50% of all respondents allowed courses that could lead to an MBA. These participating employees, however, take less than 24% of all courses allowed. Only 7 of 309 respondents said more than 50% of participating employees take courses that could lead to an MBA.
☐ 5% of participating employees receive educational assistance for other graduate-level courses (e.g., engineering).

“Continued education for our employees is a must, not a luxury.”
—Hi-tech company

“Illiteracy costs us thousands of dollars in lost productivity.”
—[illegible] company

“60% of our courses are taken to enhance current job skills; and 40% for career advancement.”
—A large company

“Growth and development of employees through educational assistance is viewed as a direct benefit to the company's profitability.”
—Aircraft manufacturer

Employers follow Internal Revenue Service guidelines:
☐ 94% of all respondents prohibited sports, games or hobby courses. To the extent sports-type courses were allowed, the classes tended to be either fulfillment of degree requirements or directly connected to company product lines.

A typical response to survey question on types of courses

Please indicate (based on your estimates) what percentage of employees receiving educational assistance take courses or instruction in each of the categories below:

	more than 75%	50-74%	25-49%	10-24%	5-9%	less than 5%	0%
Education for current job	☒	☐	☐	☐	☐	☐	☐
Basic educational skills (e.g., high school/GED)	☐	☐	☐	☐	☒	☐	☐
Community or junior college	☐	☐	☐	☒	☐	☐	☐
Bachelor's degree program	☐	☐	☐	☒	☐	☐	☐
MBA program	☐	☐	☐	☐	☒	☐	☐
Law school	☐	☐	☐	☐	☐	☒	☐
Medical school	☐	☐	☐	☐	☐	☐	☐
Other graduate level	☐	☐	☐	☐	☐	☒	☐
Hobbies, recreation, sports	☐	☐	☐	☐	☐	☐	☐

How do Employers Feel about Educational Assistance Activities?

“There are grade and dollar requirements. You must earn a "C" or better in undergraduate courses. The annual maximum support available is [illegible]. At the graduate level, you must receive a grade of "B" or better and the maximum amount per year is $1,000.”
—Small manufacturer

“The educational assistance program provides substantial financial assistance if you take, on your own time, from an approved educational institution, approved courses of an educational or vocational nature, which will benefit both you and the company”
—Midwest oil company

“The company will refund up to 80 percent of your expenses for approved courses. Books and laboratory fees are not eligible for refunds.”
—New York publisher

“The company encourages employees to enroll in courses of study that will enhance professional growth and development. Courses may be taken will be mutually beneficial to both you and the company. All courses for which you wish to be reimbursed must be approved prior to their beginning by your supervisor and the Human Resources Director. Upon completion of the course with a "B" or better, the company will reimburse you for tuition and books.”
—Small communications firm

Attitude	Most common response
Used primarily by highly-paid employees	Strongly disagree
Used by all employees including lower- and middle-paid	Strongly agree
Helps lower-paid employees as other employees may more easily pay for their own education	Agree
Is viewed as helping the advancement of minorities and women	Agree
Is viewed as an integral part of employee training and development	Strongly agree
Is considered a "perk" with little relationship to the job	Strongly disagree
Helps employees receive new skills to help with technological and other work place needs	Agree

Source: Table 11

“I was able to use my education assistance to learn skills that are immediately applicable on the job”
—A data processing employee

“Going to school is important for a better future and to help me become a more valuable employee”
—Tooling and fabrication employee

“70% of our participants are in the first five years of their employment careers.”
—Service industry

Who Conducted the Study?
What Types of Organizations Responded?

This study was conducted on behalf of the 50,000 employer-based members of the American Society for Training and Development to provide data on the scope and characteristics of employer-provided educational assistance today.

Motorola, Inc. chaired a task force on educational assistance that led to the development of the survey instrument. The survey was conducted under the leadership of Curtis Plott, executive vice president for the American Society for Training and Development, and John Robinson, manager of research and development at Motorola's Corporate Training and Education Center. Dorothy Walsh, ASTD director of government affairs, coordinated the national planning and supervised the study. Statistical consultation and development of tables was done by Robert Calvert, Jr., a consultant to ASTD and a former deputy assistant administrator for statistical services at the National Center for Education Statistics. Within ASTD, Diane Charles and Adam Stoll processed incoming forms and, with Motorola, made follow-up calls. Motorola developed the case studies and contributed to the production of the final report.

A total of 1,000 survey forms was mailed to employing organizations selected at random from the ASTD membership and other private and public sector employer lists. 340 surveys were returned. As of the cutoff date (March 29, 1985), 319 employers had responded and 309 said they offered educational assistance to employees. The tables dealing with educational assistance are based on these 309 responses.

The 309 responses represent a good cross section of employers by size (as shown in Tables 9 and 10) and type of activity (as shown in Table 1). Total employment by responding employers was 6,609,93 or approximately six percent of today's labor force of 110,000,000.

TABLE 1

Percent of Respondents Offering Educational Assistance Programs by Type of Industry and Total Employment

Type of Industry	Number Responding	Total Employment	Percent with Educational Assistance
Agriculture, Forestry and Fishing	4	53,845	100%
Mining and Construction	6	13,031	83
Manufacturing	133	3,921,434	100
Transportation	11	260,364	91
Communications	20	1,214,826	100
Public Utility	17	136,531	100
Retail and Wholesale Trade	12	386,704	83
Finance, Accounting, and Banking	34	128,657	100
Insurance	13	154,308	100
Health, Hospitals, and Related	32	87,983	97
Government	24	218,513	87
Other (educational institutions, research institutes, consulting organizations, etc.)	13	33,736	85
Totals	319	6,609,932	97%

A broad cross section of employers offers educational assistance to employees.

TABLE 2

Percent of Responding Employers Offering Educational Assistance by Size of Employing Organization

Total number of Employees	Number of Organizations	Percent Offering Educational Assistance
Under 500	38	87%
500 to 999	33	97
1,000 to 2,999	79	99
3,000 to 9,999	57	98
10,000 to 24,999	36	100
25,000 and over	76	99
Totals	319	97%

TABLE 3

Percent of All Employees Eligible for Educational Assistance by Salary Level of Employees

	Percent Eligible					
Salary Level	100%	75-99	50-74	25-49	24 or less	Average Eligibility
Under $15,000	85.2%	8.0%	1.9%	1.9%	3.0%	94.2%
$15,000-29,999	88.3	7.8	2.0	0.6	1.3	96.8
$30,000-49,999	92.1	4.5	2.8	0.6	0.0	98.2
$50,000 and over	95.1	3.1	0.0	0.6	1.2	98.1
Not specified	73.9	17.4	4.3	2.2	2.2	93.4
Total for all organizations	89.1%	6.6%	1.9%	1.0%	1.4%	96.6%

NOTE: Some organizations reported less than 100% eligibility as new employees often are not eligible and part-time staff may not be eligible.

TABLE 4

Extent to which Employers Publicize Availability of Educational Assistance Programs by Size of Organization

Total Number of Employees	Do you provide employees with information about your program through postings, etc.?
Under 500	89%
500 to 999	97
1,000 to 2,999	98
3,000 to 9,999	97
10,000 to 24,999	100
25,000 and over	98
Totals	97%

NOTE: Table based on organizations providing educational assistance programs (309 out of 319 responding organizations).

TABLE 5

Rate at which Eligible Employees Participate in Educational Assistance Programs by Size of Organization and Salary Level of Employee

Salary Level	Under 500	500 to 999	1,000 to 2,999	3,000 to 9,999	10,000 to 24,999	25,000 and over	Total by Salary Level
Less than $15,000	5.7%	14.7%	7.2%	8.7%	5.0%	6.6%	6.7%
$15,000 to 29,999	15.3	13.0	7.7	14.7	5.6	5.5	6.2
$30,000 to 49,999	12.8	17.1	7.5	14.6	7.6	6.7	7.5
$50,000 and over	8.3	14.6	2.8	3.7	1.7	3.8	3.8
Level not specified	14.2	13.0	10.2	7.0	5.1	5.0	5.2
Total by size of organization	14.4%	14.0%	8.1%	8.7%	5.3%	5.0%	5.6%

Lower-paid employees participate in educational assistance programs at a greater percentage than more highly-paid employees.

TABLE 6

Proportion of Total Participants in Educational Assistance by Salary level

Salary Level	Total Participants	Percent of Total Participants	Percent of Total Employee
Under $15,000	16,512	22.0%	12%
$15,000 to 29,999	36,893	49.1	44
$30,000 to 49,999	18,199	24.3	37
$50,000 and over	3,422	4.6	7
Total	75,026	100.0%	100.0%

The largest participation rates are in the lower salary ranges.

TABLE 7

Educational Assistance Participation Rates by Size of Organization

Number of Employees	Percent of Eligible Employees Participating
Less than 500	14.4%
500 to 999	14.0
1,000 to 2,999	8.1
3,000 to 9,999	8.7
10,000 to 24,999	5.3
25,000 and over	5.0
Total for all organizations	5.6%

14

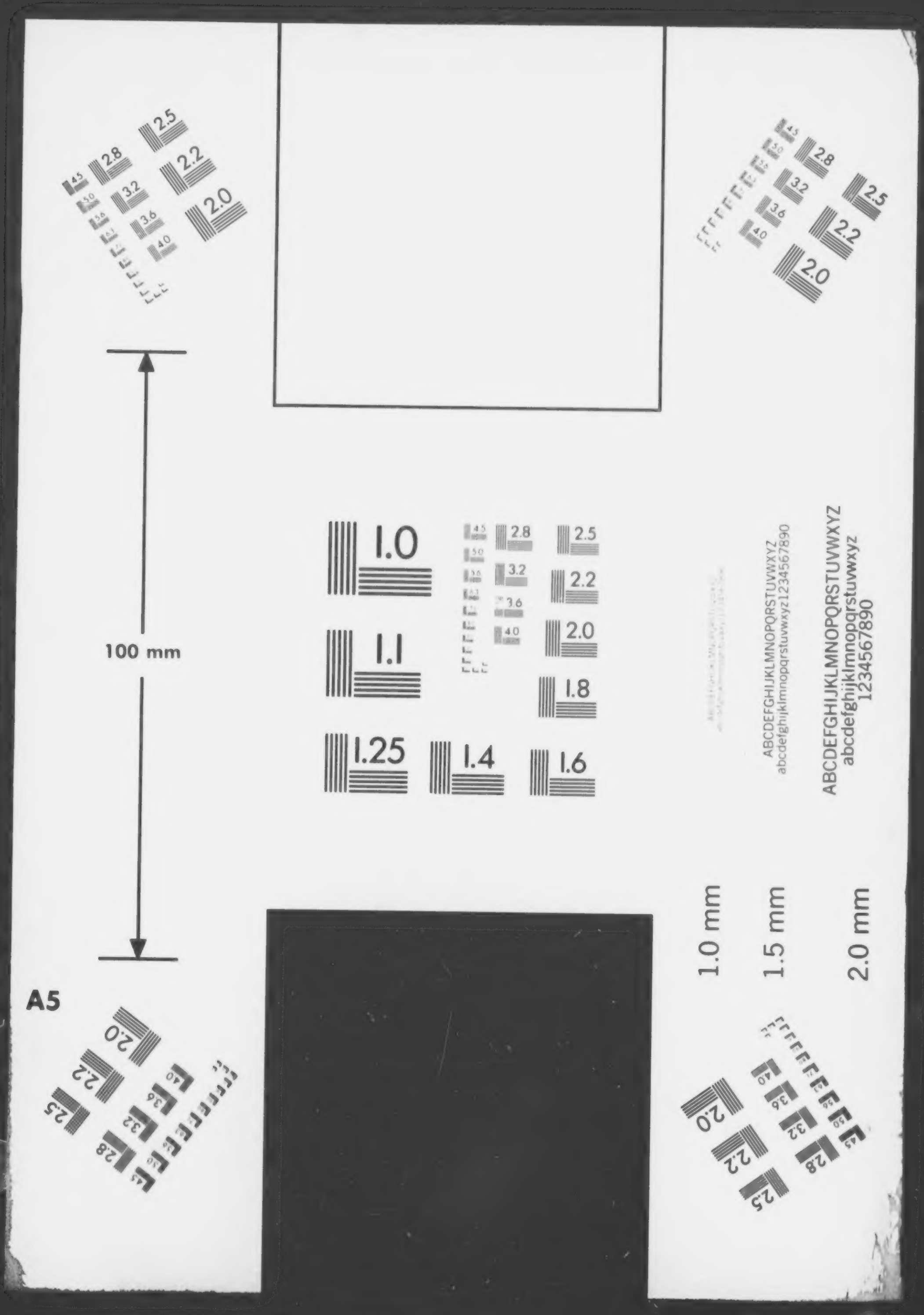

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TABLE 8

Average Amount of Educational Assistance by Size of Employing Organization and Salary Level of Employee

Salary Level of Employee	Number of Employees in Organization: Under 500	500 to 999	1,000 to 2,999	3,000 to 9,999	10,000 to 24,999	25,000 plus	Average for all Employees
Under $15,000	$250	$368	$294	$432	$355	$426	$400
$15,000 to 29,999	318	439	386	1,051	417	480	596
$30,000 to 49,999	536	591	644	1,765	623	729	870
$50,000 and over	999	2,187	951	2,583	779	1,161	1,710
Not specified	392	458	471	497	498	380	400
Average by size of organization	$376	$456	$421	$1,014	$488	$429	$491

TABLE 9

Average Amount Spent on Educational Assistance by Size of Employing Organization

Number of Employees	Number of Respondents	Total Employment by Respondents	Total Spent on Educational Assistance	Average per Organization
Under 500	32	7,864	$ 579,871	$ 18,121
500-999	26	19,868	1,210,828	46,538
1,000-2,999	64	112,780	3,903,988	60,984
3,000-9,999	52	281,716	32,854,619	631,807
10,000-24,999	33	531,845	14,345,492	434,969
25,000 plus	51	4,322,852	108,312,701	2,123,764
Total	258	5,276,925	$161,207,499	$ 624,833

TABLE 10

Participants in Educational Assistance and Total Dollars of Assistance by Size of Organization and Salary Level of Participants

Salary Level	Size of Organization, Number of Employees: Under 500 #	Under 500 $	500 to 999 #	500 to 999 $	1,000 to 2,999 #	1,000 to 2,999 $	3,000 to 9,999 #	3,000 to 9,999 $
Under $15,000	262	$ 65,477	421	$ 142,148	1,707	$ 502,099	1,939	$ 838,124
$15,000 to $29,999	327	104,130	985	256,617	3,452	1,261,078	6,818	10,236,641
$30,000 to $49,999	146	78,289	153	90,476	934	620,380	3,910	6,901,912
$50,000 and over	23	22,975	22	48,120	58	55,167	2,422	6,252,280
Level not specified	788	309,000	1,473	673,467	3,109	1,465,264	17,369	8,625,662
Totals	1,546	$579,871	2,984	$1,210,828	9,260	$3,903,988	32,458	$32,854,619

Salary Level	Size of Organization, Number of Employees: 10,000 to 24,999 #	10,000 to 24,999 $	24,000 and over #	24,000 and over $	Total #	Total $
Under $15,000	2,516	$ 890,783	10,123	$ 4,314,217	16,968	$ 6,752,848
$15,000 to $29,999	6,080	2,535,754	35,185	16,843,179	52,447	31,237,399
$30,000 to $49,999	3,487	2,167,450	16,780	12,232,498	25,410	22,091,005
$50,000 and over	297	231,516	3,267	3,786,258	6,089	10,396,316
Level not specified	17,092	8,519,989	187,285	71,136,549	227,116	90,729,931
Totals	29,472	$14,345,492	252,640	$108,312,701	328,030	$161,207,499

Educational assistance is offered by a broad cross section of employers and participation rates concentrate in the lower salary ranges.

NOTE: Since the survey did not address the definition of cost, some respondents included such items as overhead and administrative costs. And many organizations don't collect data on educational assistance by salary and cost.

TABLE 11

Employer Attitudes Toward Educational Assistance Programs

Employer-provided educational assistance is...	Strongly Agree	Agree	Disagree	Strongly Disagree	No Opinion	Total
1. Primarily designed for and used by highly-compensated employees.	0.3%	1.6%	33.2%	64.6%	0.3%	100.0%
2. Utilized by employees in a variety of compensation ranges, including lower- and middle-paid levels.	58.5	39.3	1.6	0.3	0.3	100.0
3. Benefits the lower-paid employees because the higher-paid employees can more easily deduct educational assistance as a job-related expense.	17.3	41.6	16.7	7.1	17.3	100.0
4. Viewed by my organization as a way to assist job advancement by minorities and women.	23.1	52.2	7.1	1.6	16.0	100.0
5. Viewed by my organization as an integral part of the training and development of employees.	48.0	44.4	5.1	0.6	1.9	100.0
6. Considered primarily a "perk" in my organization, which has little to do with the effectiveness of the employee on the job.	1.0	4.2	36.7	56.8	1.31	100.0
7. One way my organization helps employees receive new skills because of changing workplace needs (technology, etc.).	43.6	50.0	3.9	0.6	1.9	100.0

FIRST BANK SYSTEM, INC.

MINNEAPOLIS, MINNESOTA

Background

First Bank System, Inc. is the 21st largest bank holding company in the United States with assets of nearly $27 billion. The Company is comprised of its lead bank, First Bank National Association in the Twin Cities, and 37 other banks and trust companies, with 89 banking offices in Minnesota, North Dakota, South Dakota, Montana, Washington, and Wisconsin.

Established in 1929, the Company strives to provide complete financial services to targeted customer groups through a number of domestic and international subsidiaries and offices. These services include trust, international banking, commercial and agricultural finance, capital markets, investment management, data processing, insurance brokerage, leasing, mortgage banking, merchant banking, and brokerage services.

Rationale for Favorable Tax Treatment

Employees, as individuals, are First Bank System's most valuable resource; and as a team, our source of competitive advantage. It is essential that our employees be well educated to maximize individual potential. From our proprietary perspective, we believe that employee education is important enough to justify the commitment of significant corporate resources. First Bank System received reimbursement requests for $334,985 from employees for courses taken in 1987. It should be clear from the amount of dollars committed that we believe an investment in employee education is an investment with excellent returns to our organization. It is also an investment which we believe has clear public benefits as well. Thomas Jefferson noted in the early years of the Republic the importance of an educated polity with the statement: "No nation is permitted to live in ignorance with impunity". There are two modern trends which make Jefferson's statement even more correct today:

1) Our economy is becoming more dependent upon human resources as the service sector continues to grow faster than the manufacturing sector. As service becomes more important, investment in human resources becomes more valuable and investment in physical resources declines in importance. Allowing incentives for human investment to lapse while the latter is becoming more important would be unadvised from an economic growth perspective.

2) Economic globalization makes education a competitive imperative. The global financial services marketplace was once dominated by Americans with the Japanese a weak competitor. In 1979 only one Japanese bank was in the top ten. Now there are six and only one American 22 of the top 30 are Japanese. As we noted earlier, our employees are our biggest source of competitive advantage at First Bank System. This is also true of this country. If employers are willing to make the necessary investment in human resources to be competitive, the Treasury should be willing to make an investment as well.

Concerns Regarding Equity

The Treasury Department's comments on Section 127 are very disheartening. Treasury contends that educational assistance is of benefit to a select few and that it does not assist those most in need of assistance. It is worthy of note that neither of these arguments address the necessity of education to promote economic growth and international competitiveness. Moreover, Treasury's arguments do not lead to their conclusion. In his statement before the Senate Finance Committee, O. Donaldson Chapoton argues that "If educational training taken in order to qualify for a new job or occupation is deserving of government support, then all such training expenses should be deductible, not just those of certain employees." We agree with his statement. When Treasury has initiated such legislation and it is enacted into law, Section 127 will be superfluous. Until that point, however, it is irrational to say that we should not give this tax benefit to anyone because we cannot give it to everyone. Very little of the tax code would stand up to such a test.

In addition, the distribution of benefits is not as lopsided as Treasury contends. First Bank System's corporate policy makes tuition reimbursement available to "All regular full-time employees" as well as regular part-time employees which meet certain conditions. The policy also explicitly excludes course work in pursuit of law degrees which would skew the distribution toward higher income groups. As a result, nearly 57 percent of the requests for tuition reimbursement were for employees who were not exempt from the Fair Labor Standards Act's Wage and Hour Requirements. Even if this were not the case, the argument that benefits from this section are skewed toward high income groups does not argue for the lapse of Section 127. If the section is not extended, taxpayers will still be able to deduct job-related expenses. This would clearly favor high income groups since it would be easier for a more highly compensated manager to justify professional courses, such as MBA work, as job related. The conclusion of Congress in 1978 when Section 127 was enacted that the existing law was a barrier to upward mobility--with a disproportionate impact on lower-income employees is still correct.

Conclusion

First Bank System believes that Congress should not allow Section 127 to lapse imposing an additional tax burden on employees which would impede upward mobility, impair international competitiveness, and have a negative impact on economic growth.

HARRIS CORPORATION

I am pleased to submit this statement for the Senate Finance Committee hearing record in support of reinstating Section 127 of the Internal Revenue Code, allowing for tax-exempt employer provided educational assistance. The Employee Education Assistance Act introduced in the House as H.R.1692 and in the Senate as S.39 would reinstate this provision and make it permanent.

Since 1979, Section 127 of the Internal Revenue Code has provided a tax exclusion for employer-provided educational assistance. The provision expired on December 31, 1987. Section 127 should be reinstated, permanently, to revitalize the American economy by enhancing and developing the skills of the American work force.

Section 127 allowed employees to exclude from their gross income the value of employer provided educational assistance up to a maximum amount of $5,250 annually. Amounts in excess of $5,250 were to be included in gross income.

Without Section 127, an employee can only claim an exemption on tuition reimbursement if it is considered "job related" by the IRS. An employee can meet the "job-related" test only if the education maintains or improves an employee's effectiveness for the duties of his current job. The education must not qualify the employee for a new trade or business, or for a promotion.

In general, the IRS and the courts have tended to apply the "job related" test rather narrowly. One case cites a church's minister of music who was disallowed a deduction for music courses because they could be used for a teaching position.

This means that a clerical worker, such as a secretary, may not be able to deduct the cost of any courses leading to a degree because they are not "job related." The secretary could only deduct courses in shorthand or typing, for example.

Because the focus is solely on an employee's current job, it appears that lower level workers (whose job descriptions tend to be narrower) often have the greatest difficulty in satisfying the "maintains or improves" standard of the regulation. The expiration of the tax exemption is an obstacle to lower paid workers who wish to educate themselves for new or higher paying jobs.

More than 7,000,000 workers nationwide have participated in tuition reimbursement programs since 1978. This not only helps employees and employers, but it also helps maximize the utilization of educational facilities by employing them for evening and weekend classes. The provision especially benefits low and middle income Americans. Nationwide, in 1986, 22 percent of the participants in employee educational assistance programs earned under $15,000 annually while 72 percent of the participants earned under $30,000. Also, if the amount of reimbursement pushes an employee into a higher tax bracket, the employee would be required to fill out a revised W-4 form, at the higher rate.

Section 127 provided a needed incentive for workers to increase their knowledge and skills and to keep up with changing technology. For example, during fiscal year 1987, more than 3,150 Harris employees participated in our tuition reimbursement program which cost us nearly $2,000,000.

Without Section 127 there almost certainly will be disputes with the IRS and costly litigation as employees attempt to deduct tuition costs. The "job related" definition is narrow and its interpretation open to subjective judgment. Many companies will simply elect to withhold taxes on all tuition reimbursements, leaving the employees to defend their interpretation of what is deductible. From an employer point of view the loss of the exemption would result in increased costs. Now reimbursements have to be processed through payroll resulting in an increased administrative burden.

Given the aging of the work force, high technology's particular need for continuing education, and the need for lower paid workers to educate themselves for new or higher paying jobs, the expiration of Section 127 runs counter to the need for keeping America's work force current.

Private industry can make a unique contribution to the continued education and training of American workers who, in turn, can help this country achieve greater economic success.

Additional knowledge and skills can lead to better jobs and higher salaries. Higher salaries in turn mean higher income taxes over the long term. Although Section 127 may be considered a revenue loser initially, in the long run it will be a revenue raiser.

The need for the Employee Education Assistance Act has never been greater. At a time when the Nation's competitiveness in the world economy is in jeopardy, passage of S.39 and H.R.1692 will help both the American industry and the U.S. economy.

International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW)

This statement is submitted on behalf of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW) in connection with the hearing being conducted by the Senate Finance Committee on March 15, 1988 on tax incentives for education. The UAW strongly urges the Members of the Finance Committee to approve the legislation which has been introduced by Senator Moynihan (S. 39) to restore permanently Section 127 of the Internal Revenue Code, which exempts employer-provided educational assistance benefits from taxation.

The UAW has a long history of negotiating various types of educational assistance benefits for active and laid off workers. Today most of our major collective bargaining agreements with the automobile and agricultural implement companies, and several of the agreements with parts suppliers, provide some form of educational assistance benefits. These contracts establish tuition refund programs which pay for all or part of the cost of approved education and training courses. The tuition payment allowance varies from contract to contract, and ranges up to $2,000 per year for active workers and $5,500 for a four-calendar-year period for workers on indefinite layoff. Other types of educational and training assistance are also made available in some UAW contracts.

These educational assistance programs enable active workers to improve their current job skills, and also to obtain new skills to enhance their opportunities for advancement. These programs are also a critical part of the effort to provide retraining to laid off employees, especially displaced factory workers, to enable them to reenter the workforce.

It is widely recognized that a skilled, educated workforce is essential if America is to meet the challenges in our increasingly competitive global economy. Business and labor have joined hands in a concerted effort to provide more education and training to workers. But the federal government also has a role to play. In addition to direct federal aid to education, it is essential that the federal government continue to provide incentives for private sector involvement in skill development.

Since 1978, Section 127 of the Internal Revenue Code has exempted employer-provided educational assistance benefits from taxation. This has greatly encouraged the growth and development of private sector efforts, such as our collectively bargained tuition refund programs, to enhance worker skills and training.

Under the Tax Reform Act of 1986, Section 127 was scheduled to expire at the end of 1987. In response to this situation, Senator Moynihan introduced S. 39, to make permanent the tax exempt status of employer-provied educational assistance benefits. Unfortunately, the House and Senate were not able to act on this measure during the 1st Session of the 100th Congress. Accordingly, employer-provided educational assistance benefits became taxable beginning January 1, 1988.

The expiration of Section 127 will result in a significant tax increase for thousands of workers. This could undermine worker support for education and training programs. The additional administrative burdens associated with taxation of these benefits may also undermine employer support for these programs. Thus, the UAW is deeply concerned that the taxation of employer-provided educational assistance benefits could have a deleterious impact on the continued growth and development of these education and training programs.

Reinstatement of Section 127 will not entail a substantial loss of revenue to the federal government. The UAW submits that the tax expenditure associated with Section 127 represents a wise investment in the economic future of this country. If we are serious about providing our workers with the necessary skills and training as one of the ingredients for a competitive America, the federal government must continue to encourage the private sector to provide educational assistance benefits to active and laid off workers. Accordingly, the UAW strongly supports S. 39, and urges the Finance Committee to act favorably on this important measure.

The UAW appreciates the opportunity to present our views on the subject of tax incentives for education. Your consideration of our views on this issue will be appreciated. Thank you.

566 Westview Avenue
State College, PA 16803

March 13, 1988

To whom it may concern;

My name is Laura M. Karkowski and I am a Ph.D. candidate at Penn State University in the Intercollegiate College of Genetics. I am writing to the Senate Finance Committee to illustrate a situation that is creating unacceptable financial problems for graduate students at Penn State and other universities across the nation.

The cause of the financial problems is the taxation of tuition grants, scholarships, fellowships and other educational assistance as a result of the Federal Tax Reform Act of 1986. This change in the Tax Code has caused an additional $900 to be witheld from my effective stipend of less than $7000 ($6700 in 1987). This will cause nearly a 13% decrease in the amount of money available to me in 1988 for living expenses.

I am a graduate research assistant studying the effects of alcoholism and aging in a well-funded field of scientific research, yet this month because of the additional witholding I brought home a paycheck of just over $370. Housing costs in State College frequently exceed $300 a month and the cost of food alone can easily consume the rest of my paycheck. Even University housing is not much cheaper. In my budget there is simply no allowance for "extras" such as books, insurance, or clothes.

Clearly, graduate students in my position are in a serious situation. We are working for ourselves and the future our nation. However, these taxes on academic support are crippling our ability to pursue vital research and educational goals. The costs of education are high as it is; taxing grants based on academic merit will simply ensure that only the independently wealthy can pursue higher education.

I urge you to support legislation that will restore tax benefits to academically qualified students. In addition, please give consideration to ways of ensuring that our citizens in pursuit of advanced degrees have adequate support for their research and educational goals.

Sincerely yours,

Laura M Karkowski

Laura M. Karkowski

GEORGE KOCH SONS, INC.
Established in 1873

Address Mail to Post Office Box 358
EVANSVILLE, INDIANA
47744
TELEPHONE (812) 426-9600
TELEX II 810-353-0527
FAX 812-426-9724

March 29, 1988

Ms. Laura Wilcox
Hearing Administrator
SD-205 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Ms. Wilcox:

The purpose of this letter is to express support for reinstatement of Section 127 of the Tax Code allowing employees to exclude employer-provided tuition reimbursements from taxable income.

Our Company, George Koch Sons, Inc., is a manufacturing firm employing over 400. We compete, as do most American manufacturing firms, in a highly competitive, rapidly expanding world market which requires the continued education of all employees.

We have had a long-standing tuition reimbursement program which encourages employees to improve their skills through job related vocational and university level courses. We feel that requiring employees to treat tuition reimbursement as taxable income would discourage the continued education that we feel is necessary to the successful operation of our business.

Please support reinstatment of Section 127 of the Tax Code to allow the exclusion of tuition reimbursement from taxable income.

Very truly yours,

GEORGE KOCH SONS, INC.

Samuel L. Woehler
Mgr. Personnel & Safety

SLW:rab

Lawrence Livermore National Laboratory

Laura Wilcox
Hearing Administrator
SD-205 Dirksen Office Bldg.
Washington, D.C. 20510

April 5, 1988

Dear Ms. Wilcox:

We at Lawrence Livermore National Laboratory strongly urge support of retroactive reinstatement of Section 127 of the Internal Revenue Code which expired December 31, 1987.

Our workforce of approximately 8,000 employees includes over 2,700 scientists and engineers, and 3,100 technicians and crafts support personnel engaged in defense and energy related research and development. LLNL's position as a world leader in research and development is due in no small part to the educational opportunities provided through our employer-sponsored programs.

The role of education within LLNL is crucial. Our Laboratory has a variety of major weapons, energy, biomedical and basic research projects that demand the most current knowledge available. The project orientation of our work requires a workforce that has broad-based skills and flexibility for reassignments. Educational opportunities help build that flexibility.

With the expiration of the Employer Educational Assistance (EEA) Act, LLNL, as many other research and development organizations, is spending many manhours trying to minimize the impact on our employees and on the educational profile of our future workforce. Already we anticipate a decline in educational program enrollments.

As you may know, with the absence of the EEA, Section 127, there is very little clarity with regards to what constitutes allowable job-related educational expenses. Our informal surveys of similar organizations indicate a variety of response strategies. Organizational procedures range from withholding on all courses, to decisions not to withhold.

Our legal counsel indicates that current tax rulings generally interpret any coursework leading to a degree to be nondeductible (and hence taxable). We find this to be an excessively restrictive interpretation that penalizes the more than 300 LLNL employees majoring in science, engineering and computer science - all fields necessary to support the Laboratory mission.

Based on this understanding, we are withholding approximately 30% of each tuition reimbursement check - substantial amounts in view of tuition costs at Stanford and other private institutions.

This disincentive compounds an already difficult educational issue in the field of engineering. Nationwide, demand for graduate level engineers far outstrips university ability to generate graduates. As a result, LLNL, as many other organizations, hires BS level engineers with the strong encouragement to complete graduate education.

In conclusion, we wish the Senate Finance Committee to recognize the potential costs of not reinstating Section 127. We, as citizens, are certainly desirous of reducing the national deficit, and are cognizant of the projected three hundred million dollars of annual revenue that may be received as a result of the expiration. However, the loss of educational development to LLNL's workforce, and, on a larger scale, to the United States' workforce, cannot be as easily quantified. The loss will be gradual and certainly long term.

Sincerely,

Dennis K. Fisher

Dennis Fisher
Chairman, Student Policy Committee
Associate Director, Engineering

105 Steidle Building
University Park, PA 16802
(814)238-6949
March 10, 1988

U.S. Senate Committee on Finance
U.S. Senate
Washington, D.C. 20510
Attn: Laura Wilcox

Dear Sirs,

My name is Lori L. Lundberg and I am a graduate student and a member of the Students for an Accessible Future in Education (S.A.F.E.) committee at the Penn State University. I am writing to make you aware of a problem that is creating hardships for graduate students.

The issue causing the hardship is the taxation of tuition on research assistants due to the Federal Tax Reform Act of 1986. This change in law has increased the tax burden of the research assistants at Penn State by $3500 per year and amounts to an additional withholding of approximately $900 per year. This is at least a 10-15% decrease in our stipends.

To illustrate the unfairness of this tax, my husband is on a research budget where his tuition is taxable and I am on internal funds where my tuition is not taxable, yet we both perform the same duties. Together we earn $980 per month. Our apartment costs $450 per month, together with groceries, car insurance, phone bill, car upkeep, and other incidentals we have no money left over for any kind of health insurance or other emergencies let alone a social life or a savings account.

Further, graduate students cannot be claimed as dependents by parents so they get very limited financial help if any and no medical coverage. Most graduate assistants are not eligible for Guaranteed Student Loans or other types of financial aid because of the stipends. We are not "employed" by anyone, therefore being voluntarily unemployed we cannot get unemployment while looking for a job and most cannot qualify for food stamps. Also, the University forbids a graduate student to seek outside employment for extra earnings.

It is a well-publicized statistic that the quality of life in the United States varies directly with the technological advances being made. There is also another statistic that the number of graduate students is decreasing while the need for them is rapidly increasing. My husband and I are Master's Degree students and had previously thought we might go on for a Ph.D., but this has now become an impossibility. If we get no financial help at all very soon, we might not be able to finish the Master's program.

The members of the S.A.F.E. committee have been diligently working to bring the plight of the graduate student to public and government attention through petitions, letter-writing, and phone calls. This is a very serious situation which needs immediate attention.

Sincerely,

Lori L. Lundberg

BEST COPY AVAILABLE

Massachusetts Education Loan Authority
711 Atlantic Avenue
Boston, Massachusetts 02111

(617)338-1253

April 13, 1988

VIA FEDERAL EXPRESS

Honorable Lloyd Bentsen
Chairman
Committee on Finance
SD-205
Dirksen Senate Office Building
Washington, D.C. 20510

Re: S. 2149 -- Student Loan Arbitrage

Dear Mr. Chairman:

On March 15, 1988 the Committee on Finance held a hearing on "Tax Incentives for Education," during which testimony was presented on S. 2149. I am requesting that this letter be included in the record in support of S. 2149.

The Massachusetts Education Loan Authority (MELA) strongly supports adoption of S. 2149, a bill introduced by Senator Mitchell "to amend the Internal Revenue Code of 1986 to allow State secondary markets of student loan notes to continue serving the educational needs of post-secondary students and the Nation." The bill would make permanent the student loan arbitrage rule and extend it to supplemental student loan programs such as MELA's Family Education Loan Program. This legislation is crucial to MELA's continued ability to provide low cost educational financing to families of moderate means. The need for such programs is expected to increase as other forms of financial assistance become more limited and restricted.

As described below, MELA's program is structured to assure that the benefits of tax-exemption are directed to students with real need. MELA's program enables students from families who need assistance financing higher education to attend colleges and universities that would not normally have the financial resources, or the access to credit markets, that would allow them to offer adequate financial assistance.

What Is MELA

The Massachusetts Education Loan Authority (MELA) is an independent public authority created in 1982 to provide a source of low cost educational financing to the families of low- and middle-income students attending Massachusetts colleges and universities, without regard to the residence of the student or family. As of this time, approximately 9,000 loans have been made under MELA's program and the need is growing. At the time of its initial bond financing in early 1983, nine independent colleges and universities participated. Now more than four dozen public or independent institutions offer the program. MELA's unsecured loans are at a fixed rate, have a fifteen year repayment period and low monthly payments. The minimum loan is $1,500. The maximum loan is limited to the difference between the student's total cost of attendance and the other forms of student assistance received. Thus, MELA's program is a "qualified student loan program" under the Tax Reform Act of 1986.

Massachusetts determined that a supplemental student loan program was needed because of the state's above-average cost of post-secondary education and the limited availability of existing federal student assistance, such as the GSL program, to families of modest means. The Commonwealth of Massachusetts has the highest percentage of students enrolled in independent institutions, at which the students and their families must pay for all the costs associated with providing that education. The state's resulting above-average educational costs create significant financial burdens for moderate-income families. MELA was created to provide these families a stable, low cost source of educational financing.

As intended, the borrowers in MELA's program are in fact from families of moderate means. Over eight percent of MELA's borrowers have family incomes below $30,000 and over seventy percent have family income below $69,000. Many of the families in the upper income levels are supporting two or more dependents in higher education. Thus, MELA's loan program bridges a critical gap in higher education financing by providing financial assistance to those families whose income is high enough to limit their eligibility for traditional need-based financial assistance such as the GSL program, but not high enough to permit them to independently pay the full cost of education from their current income.

The MELA program is distinguishable from comparable federal programs because (a) there is no federal guarantee, (b) there is no grace period for repayment of principal or a 60 day deferment of interest, (c) there is no limit on the interest rate that may be charged or the aggregate absolute dollar amount that may be borrowed and (d) Participating Institutions have direct financial responsibility for defaulted student loans.

Eligibility

A family's ability to borrow under MELA's program is based on (1) their ability to carry debt, as measured by standard credit criteria, and (2) family income, relative to the cost of education, as measured by the Congressional Methodology of student need analysis. The first test insures that the credit of MELA's borrowers is sound; the second test insures that MELA's bond proceeds are used to achieve its public purpose and are used by the targeted population. If the calculated family contribution toward the cost of higher education is no more than the median cost of attendance for all institutions in the program, the family can borrow up to the total cost of attendance less other financial assistance; if the family contribution is above that level, eligibility to participate is reduced by means of a formula developed by MELA.

The MELA Program

Tax-exempt financing is crucial to MELA's ability to meet its legislative mandate to lower the cost of financing higher education. MELA's program, financed by selling tax-exempt bonds on a pooled basis, encourages financially stronger institutions to participate with financially weaker institutions. Absent this incentive, the few wealthy institutions would lend from their endowments or bank credit lines only for the benefit of their students and parents. The vast majority of institutions that have not developed large amounts of endowment per student would thus be at a double disadvantage -- they would have less institutional scholarship money than their wealthier counterparts and they would have no access to institutionally-supported loan funds. In the absence of family loan programs like MELA's, higher education loans would be available only at wealthy educational institutions and, in the case of upper income families, from banks.

The MELA program stands on its own, with borrowers paying a fixed interest rate adequate to cover repayment of the bonds and program administration expenses, including a prudent reserve for defaults. The participating colleges and universities also contribute administratively and financially to making the program work, including the assumption of liability for defaults if they should exceed the level covered by program reserves (under the GSL program, there is no such institutional participation). Thus, the program is truly a self-help program for parents and students on the one hand and a self-help program for participating institutions on the other.

It is important to reiterate that Congress has already made the determination that supporting higher education by assuring broad access to student loan funds through the issuance of tax-exempt bonds serves a crucial public purpose. MELA's supplemental student loan program unquestionably meets that public purpose by enable moderate-income students and their families to afford the costs of higher education and by making those benefits available at a wide range of institutions. The student loan arbitrage rule, which would be made permanent and applicable to supplemental student loans under S. 2149, is necessary to assure a viable, continuing student loan program.

Need For S. 2149

Families should plan the financing of a college education more than one year at a time. Students, their families and institutions of higher education need assurances that MELA can provide a continuing loan program.

The Massachusetts Family Education Loan program attempts to provide a commitment to a continuing financial assistance program. MELA is a foreward-financing program, in that it provides funds for future loans to be made by participating institutions. These institutions -- and their students and their families -- must be assured in advance that funds will be available to finance the costs of several years of attendance. To work, MELA's program must be able to assure participating institutions that the funds are there for student loans. Adoption of S. 2149 is essential.

S. 2149 will provide a permanent exemption from the rebate requirement that will enable MELA to address the "non-origination contingency" of not acquiring student loans with the bond proceeds and therefore not being able to pay back the costs of issuing and carrying the student loan bonds. Because there is no practical alternative sources of funds, unlike IDBs and governmental bonds, issuers like MELA must have the opportunity to earn and retain sufficient arbitrage during the 18 month temporary period. This will enable issuers to assure the bond rating agencies that in a worst-case situation, where student loans are not made/originated, there would be sufficient funds to pay for the redemption of the bonds plus the costs of issuing the bonds and the interim operating expenses that were incurred. Of course, we would not expect to be able to recover these costs twice, once through earnings on the investment of the bond proceeds during the temporary period and again through earnings from the student loans. We would endorse a clarification to S. 2149 to make this explicit.

Student loan programs also need the permanent 18 month temporary period provided in S. 2149 in order to accommodate the slow origination process inherent in education loans. Bonds must be issued no later than June 1 in order for families intending to send a child to school in the fall to know what the interest rate will be on a loan. But, to manage responsibly the education loan program and to insure that the bond proceeds are used only for higher education expenses, funds cannot be released by MELA for the purpose of making loans until after the school year has begun in September. Thus, one-half of the six-month temporary period would be gone before loans may even be originated. Further, as previously noted, students and their families do not borrow just for one semester at a time, but borrow for the academic year. The bond proceeds cannot reasonably be expended within the six month temporary period provided for supplemental student loans.

Finally, the costs associated with the extended nature of the loan origination period and the administrative costs attributable to the low individual dollar size of the supplemental student loans are also unique to higher education programs and further justify allowing retention of arbitrage earnings to the extent that costs are not paid from loan repayments. Otherwise, these costs would be passed on to the students and their families in the form of higher interest rates and origination fees, thus defeating the purpose of the program and further exacerbating the problem of the rising costs of higher education.

CONCLUSION

The Massachusetts Education Loan Authority supports enactment of S. 2149 to make permanent and extend the current student loan arbitrage rule to supplemental student loan bond programs. MELA provides a unique program to lower the cost of financing higher education and to make these benefits available at a wide range of participating institutions. Through its minimum eligibility criteria, these benefits are targetted primarily to students and their families of moderate means. To keep this program alive, we urge adoption of S. 2149.

I would be pleased to respond to any questions the Committee may have regarding MELA's supplemental student loan bond program.

Sincerely,

Paul Combe
Executive Director

MID-FLORIDA PERSONNEL ASSOCIATION
mFpA
A.S.P.A. CHAPTER 151

MFPA
P.O. Box 1894
Bartow, Florida 33830

April 8, 1988

Ms. Laura Wilcox
Hearing Administrator
SD-205 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Ms. Wilcox:

The Mid-Florida Personnel Association (MFPA) is an association of Human Resource professionals from nearly 100 companies in west central Florida, collectively employing over 50,000 people. MFPA is associated with the American Society for Personnel Administration.

It is our understanding that the Senate Finance Committee has recently held hearings on S. 39, the Educational Assistance Act, which would reinstitute Section 127 of the Tax Code. That section which expired December 31, 1987, permitted employees to exclude employer-provided tuition refund payments from their taxable income.

The purpose of this correspondence is to advise you that the MFPA wholly supports reinstitution of this exclusion. It is the experience of MFPA members that tuition reimbursement programs have a motivating effect upon employee groups, offering them an affirmative, progressive benefit for preparation for career advancement.

Would you please submit our endorsement of the Educational Assistance Act for the Senate Record.

Sincerely,

Mid-Florida Personnel Association

Jay W. Bloise

Jay W. Bloise
President

JWB/lf

NATIONAL ASSOCIATION OF MANUFACTURERS

I am pleased to have the opportunity to submit a statement for the Finance Committee hearing record on behalf of the National Association of Manufacturers in support of reinstating Section 127 of the Internal Revenue Code, allowing for tax-exempt employer-provided educational assistance. In addition to representing NAM, I serve as co-chair of the national Coalition for Employee Educational Assistance, a group representing hundreds of educators, businesses and unions dedicated to employee educational assistance.

A competent, well-trained work force is central to the economic vitality of the country and essential to our ability to meet global competition. This is especially critical in the manufacturing sector, where employees must be ready to expand both technical and analytical skills so U.S. producers can adapt to rapidly changing market forces.

One of the greatest challenges facing our nation during the twilight of the twentieth century will be meeting the crisis in our educational system. Our strength as a nation requires that U.S. citizens be on par academically with citizens throughout the developed world. The education crisis certainly goes beyond this hearing or the jurisdication of the tax-writing committees. It is also one of the fundamental competitive challenges facing U.S. manufacturers.

The NAM believes that private employers play a substantial role in improving the vocational and educational level of our society. Already private industry has the largest and most experienced training system in our economy. Programs like Section 127 play a vital role in encouraging businesses, educators and employees to work together to improve education levels, and then to transfer those new skills to the workplace.

Unfortunately, IRS Section 127, which allows employers to provide their employees with tax-exempt tuition payments, ended on January 1, 1988. Unless it is retroactively extended, millions of employees must chose to either pay significantly higher taxes or drop continuing education programs. Employers and the IRS will have to return to the confusing and burdensome deductibility rules pre-dating Section 127, which severely limit tax-exempt tuition aid. Because the old rules are indirectly biased against lower-level employees, lower income workers are the first to suffer from the loss of Section 127.

Section 127 was enacted specifically to eliminate the confusion and inequities created by a prior Treasury regulation (Regulation Section 1.162-5). This regulation required employees to demonstrate that any educational assistance provided by employers be directly related to their current position. Employers either had to withhold taxes on all educational assistance or determine, on an individual basis, whether each course an employee took was specifically "related" to present job responsibilities. The more narrowly defined the job description, the more narrow the list of eligible coursework. Factory workers, support staff and clerical employee were severely limited in the type of qualifying courses. Meanwhile, managers and other higher-level executives were able to legitimately justify a broad range of coursework as related to their current job.

In 1978, led by Senators Bob Packwood and Jacob Javits, Congress recognized the confusion stemming from the Treasury regulations, and more importantly, the need for broader educational incentives. It enacted Section 127, permitting employees to exclude from gross income any educational assistance benefits provided by employers. To qualify, plans must be available to all levels of employees, but can include "any form of instruction and training that improves or develops the capabilities of an individual."

The original legislation was enacted for five years and expired at the end of 1983. While Section 127 was eventually extended for two years in October of 1984, the uncertainty created confusion for employees and additional paperwork for businesses. Additionally, the benefit was scaled back by limiting the tax-exclusion to $5,000 annually and requiring stricter reporting from employers.

Section 127 lapsed again at the end of 1985, and this time the uncertaintly lasted until it was retroactively extended for two more years as part of the 1986 Tax Reform Act. The annual cap was increased to $5,250, and Section 127 was expanded to include tuition benefits granted to graduate assistants and other graduate students receiving reimbursements from universities. Without Section 127, graduate students will be required to pay tax on their tuition reductions.

Even with its rather shaky existence, Section 127 has been successful in encouraging employees to develop new skills. Since its enactment nearly a decade ago, seven million workers have taken advantage of educational assistance programs. Lower income employees especially have benefited, and NAM estimates that most of the employees participating in employer-provided educational assistance earn wages below $30,000. Graduate and post-graduate studies, which often qualify for tax deductibility under Regulation Section 1.162-5, are clearly an important part of educational assistance. But studies conducted by the American Society for Training and Development (ASTD) have found that the bulk of individuals who use a tuition reimbursement program do so to improve basic educational skills, (reading, writing, math, etc.) or for courses leading to a bachelor's degree, purposes which seldom qualify for deductibility under Regulation Section 1.162-5.

When surveyed by ASTD, employers attitudes were strongly supportive of educational assistance programs. There is almost unanimous agreement that programs are implemented not as a "perk" for employees, but as an intregral part of employee training and development goals. Employers also believe a program's success depends on its utilization by employees at all levels in an organization.

Because businesses must have trained and knowledgable workers to be competitive, corporations are among the most committed supporters of education. Nearly all Fortune 1000 companies have educational assistance programs for their employees. Last year alone companies provided over $70 million in tuition support, with the average amount of tuition aid per participant at around $491. This money is in addition to the billions spent each year by businesses on internal training and development programs.

Investment in education is an expenditure this nation cannot afford to ignore. Yet budget contraints and wasteful spending limit the ability of the government to meet the educational challenge directly. Instead, incentives like Section 127 should be retained so those actually involved in the vocational and educational training of our workforce—educators, businesses and employees—can continue to develop the skills and knowledge of our people.

MOTOROLA INC.

March 31, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Finance Committee
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Bentsen:

On March 15, 1988, your committee held hearings on the Tax Incentives for Education. On behalf of Motorola I would like to have my comments on Section 127 of the Internal Revenue Code included in the hearing record.

Continuing Adult Education was dealt a tough blow on December 31, 1987 when IRC-127 expired. That is when many forms of tuition reimbursement again became taxable.

Motorola is already seeing the first effects. Many female and minority employees who were just getting by simply cannot afford to pay $200-$800 in additional taxes. Although the tax law allows them to deduct some forms of educational expenses, many do not itemize and are thus penalized.

The timing could not have been worse... Just when we need to improve the technical and basic skills of the American workforce, many are discouraged by a tax law they don't understand and believe is unfair. I am enclosing several examples of its effect on our female and minority employees.

I am asking the committee's support in seeing that S.39, which would permanently restore the Section 127 tax code exclusion for employer-paid tuition reimbursements, be extended retroactively as soon as possible.

Thank you for your consideration of this matter.

Sincerely,

Travis Marshall
Senior Vice President
Director of Government Relations

Enclosure

cc: The Honorable Daniel Moynihan
The Honorable Bob Packwood

Government Relations: 1776 K Street, N.W., Suite 200 Washington D.C. 20006 (202) 862-1500

1. Female Secretary; single, age 28; weekly salary $398[1]; degree sought, Associate of Arts in Accounting from Elgin Community College; anticipated 1988 reimbursement[2] $400; tax impact $60.

2. Female Secretary; minority, married, age 37; weekly salary $382; degree sought, MBA in Marketing from "Illinois Institute of Technology;" anticipated 1988 reimbursement $1700; tax impact $255.

3. Female Senior Manufacturing Engineer; single, age 28; weekly salary, $756; degree sought, MBA in Operations Management from Northwestern University; anticipated 1988 reimbursement $6450; tax impact $1806.

4. Female Production Worker; minority, married, age 40; weekly salary $394; degree sought, AA in Electronics from Elgin Community College; anticipated 1988 reimbursement $400; tax impact $60.

5. Male Programmer/Analyst; minority, single, age 40; weekly salary $730; degree sought, MS in Computer Resources Management from Webster University; anticipated 1988 reimbursement $2400; tax impact $672.

6. Male Systems Engineer; minority, single, age 26; weekly salary $750; degree sought, MBA in Marketing from the University of Chicago; anticipated 1988 reimbursement $4000; tax impact $1120.

[1] Salaries noted are gross, bwfore tax salaries.

[2] Anticipated reimbursements for 1988 are actual reimbursements for 1987.

NATIONWIDE INSURANCE COMPANIES

Nationwide Enterprise provides assistance to their employees to allow employees to further their education and to upgrade their current skills. It is our philosophy that education does not end with the conferment of a high school diploma or a college degree. Learning is a lifelong process; one that we encourage and support. We are strongly committed to the development of our workforce and urge you to make Section 127 a permanent part of the Internal Revenue Code. Educated citizens and workers are priceless assets neither government nor business can afford to lose.

Who Uses The Nationwide Educational Assistance Plan?

Nationwide employees working 32 hours per week or more are eligible to participate in the company's educational assistance program. Employees of all pay grades and positions use the Educational Assistance Plan -- from the mail clerk, secretary, computer programmer, underwriter, to the supervisor and manager. We estimate 50-60 percent of our reimbursements are made to employees with a low to moderate income who are seeking to improve their skills. These employees hope to upgrade their standard of living through education so they can qualify for positions of increased responsibility and more pay. The elimination of Section 127 will hurt these employees the most. The number of employees participating in this program has increased every year. Recent participation shows:

	Number of Nationwide Employees	Number of Nationwide Employees Participating in Educational Assistance Plan	Percentage Actively Participating
1985	13,905	1,906	13.7
1986	14,257	2,311	16.2

According to the National Institute for Work and Learning, companies that actively promote educational assistance programs experience a participation rate of between 10 and 12 percent. We enjoy even higher rates of participation, perhaps due to the emphasis we place on continuing education.

However, we expect these figures to decline with the expiration of Section 127 and the taxation of certain employee educational assistance reimbursements.

What Is Covered Under Educational Assistance Plan?

Nationwide's program covers employees in the following areas:

1. Technical Insurance Courses - These courses are available under the sponsorship of insurance education organizations such as The American College, Insurance Institute of America, and Life Underwriter Training Council. These courses help our employees keep abreast of the changing insurance industry.

2. Certification Courses - Reimbursement is available for programs that lead to certification with a designation by a nationally recognized professional organization such as Certified Financial Planner, Certified Public Account, and Certified Computer Programmer.

3. Other Courses - Reimbursement is available for courses offered by universities, colleges, high schools, night schools, and correspondence schools provided the education has potential application at Nationwide.

What Effect Does The Repeal Of Section 127 Have On Nationwide?

The repeal of Section 127 has affected Nationwide and its employees in numerous ways. Since over 50 percent of the educational assistance payments will be taxable and subject to withholding, the level of participation will decrease.

Our Home Office is in Columbus, Ohio where the cost of one class from a private night school approaches $400, which is close to the national average. And these tuition costs are increasing an average of over six percent per year. Although it is too early to tell how drastic the decline in participation will be, feedback from our employees indicates many will not be able to afford the rising cost of tuition without some incentive and tax-favored reimbursement.

Moreover, the majority of our employees who go back to school support families, work full time, and attend night and weekend classes. The educational assistance program provides the extra incentive needed for employees to take the time and make the commitment to further their education.

Returning to the old rules of deductibility under Regulation 1.162 introduces a substantial degree of uncertainty and forces companies to make some subjective determinations that have proved to be frustrating to both employees and employers.

This is not a practical way to raise revenue. Certainly the time and effort our company has invested to attempt to comply with the repeal of Section 127 does not justify the return.

In 1986 we reimbursed employees $473,248 under our educational assistance plan. Each year we average a 20 percent increase in reimbursements. In 1988 we estimate reimbursements will be close to $681,000, and of those reimbursements approximately 50 percent will be subject to tax. Based on an average withholding percentage of 30 percent, the government can expect to generate only $102,150 from Nationwide employees to reduce the deficit. This hardly seems worth it especially since our program participants tend to be the "indians" instead of the "chiefs." Additionally, our employees have spent over 500 hours working to put procedures in place to withhold these taxes.

Finally, educating our workforce is our investment in our company's and our country's future and anything that discourages rather than encourages that investment will be counter-productive in the long-term.

In short, we believe the repeal of Section 127 is impractical, unfair, and unwise. We would also like to comment on some public policy issues that result from the expiration of Internal Revenue Code 127.

Public Policy Issues

Allowing Internal Revenue Code Section 127 to expire is a short-sighted attempt to raise current revenues at the expense of future improvements in productivity and tax revenues. Taxing these benefits could result in increased reluctance by employers to start or continue Educational Assistance Plans - as a result of increased administration, payroll processing, and payroll taxes as well as introducing employee relations problems. We offer some additional comments concerning Educational Assistance Plans and public policy.

Educational Assistance Plans Are Broad Based Programs. Under the prior code sections, any employer could adopt a tax-favored educational assistance plan, provided the plan was clearly communicated to employees, provided benefits to employees in a non-discriminatory fashion and provided that the employer complied with a variety of reporting requirements as required by Treasury Regulations 1.127-2.

In 1985, the American Society for Training and Development studied employer provided Educational Assistance benefits and found:

1. Most respondents, 97%, sponsored Educational Assistance Plans,
2. Most small businesses (87%, under 500 employees) had plans and that small businesses had the highest rate of employee participation (14%),
3. Most respondents, 96%, indicated that such training was helpful on the current job, and that nearly 55% used the program to improve basic literacy skills, and
4. The majority of employees who participated were from lower salary ranges - 93% of those participating would not meet the definition of "highly compensated employee" at most firms (under $50,000 in income per year).

Educational Assistance Plans Provide Opportunity. A variety of firms use their educational assistance plans in combination with the Targeted Jobs Tax Credit, provided under the Internal Revenue Code, to hire the otherwise unemployable. A number of other firms use the Educational Assistance Plans to provide retraining to employees displaced by technology or changes in production. Some even use their programs to retrain individuals as they enter new careers upon retirement. Clearly, in most of these situations, the training or retraining would fail the Treasury Regulation 1.162-5 requirements for exclusion since the training or retraining would either "meet the minimum job requirements" or "qualify an individual for a new trade or business."

Educational Assistance Plans Are Long Term Revenue Enhancement Programs.

Long-term tax revenue goals can only be met if Americans as a whole remain productive and increase their productivity. To quote Senator Moynihan, from the Congressional Record, Volume 131, No. 23, February 23, 1985:

> ". . .this opportunity for firms to help train their employees, is of great value to the American economy as a whole. American private enterprise must continue to advance technologically, if we are able to remain competitive in the international economy. Educated employees, from researchers to assembly line workers, enable American business to remain competitive with and surpass the rest of the world. . ."

Two times in the past, Congress has heeded these arguments and has extended the exemption contained in Internal Revenue Code Section 127. One valuable by-product of these programs, has been the increased development of numerous community college systems and a variety of evening programs at universities and colleges. These foster closer working relationships between employers and educators - improving the capabilities of Americans as they enter the workforce for the first time, or reenter the workforce after a period of retraining. Such close cooperation between employers and educational institutions should be encouraged, not taxed.

We suggest the example of the GI Bill be reviewed for comparison purposes. We believe that there exists a variety of studies of the favorable impact of the bill - in terms of its impact on the post World War II, Korean War and Vietnam War economies. Most studies indicate that the return through increased productivity, and increased taxes (adjusted for inflation and time) far exceeds the initial investment of tax revenues.

For these reasons, we strongly recommend you make Section 127 a permanent part of the Internal Revenue Code.

C. Brian Filsinger
Vice President

Human Resources Division
69 State Street
Albany, NY 12201
518 447 4269

NORSTAR BANK
UPSTATE NY

April 4, 1988

The Honorable Lloyd Bentsen, Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

The New York State Office of the American Institute of Banking (AIB) urges the Committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

Today, AIB is the largest educational division of the American Bankers Association. Four hundred chapters enroll 350,000 persons each year in education and training programs. Admission to AIB is available to employees, officers, and directors of banks. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will qualify them for career advancement.

[illegible] participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: [illegible] Banking, Consumer Credit, Commercial Lending, Mortgage Lending, [illegible] Service, Securities Services, Supervisory Skills, and Accelerated [illegible] Study.

[illegible] banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The New York State Office of the American Institute of Banking urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

C. Brian Filsinger

C. Brian Filsinger
New York State Chairman, AIB

CB?/ffp

Robert C. Jubelirer,
President Pro Tempore
Senate of Pennsylvania

I am pleased to have the opportunity to submit to the members of the Senate Committee on Finance my views on the important issue of providing tax incentives for individuals and families who must plan and save for future higher education expenses. In particular, I encourage the Committee to introduce and endorse legislation that would exempt from federal income tax any appreciation in the value of pre-purchased tuition.

Over the past two decades, we have witnessed debate over issues of individual saving habits and the consequent creation of programs to provide incentives. Encouraging saving for retirement years and increasing access to home ownership are two examples where concerns about costs have lead to innovative government policies.

Now, college costs and questions of affordability and access have captured public attention and piqued legislative interest. College costs, particularly tuitions, are climbing. Parental participation in paying for college cost is dropping proportionately.

Federal student aid has dropped significantly since 1980, and the form of that aid has shifted decidedly toward loans. The net effect of these changes has been to shift an increasing proportion of the burden of paying for college away from both government and parents toward the students themselves. The costs of higher education are being shifted to the next generation. Evidence also suggests that an increasing student indebtedness is having negative effects both on who goes to college and on student selection of majors and careers.

Certainly, it is in the national interest to provide quality post-secondary education and to insure that interested and qualified individuals have access. Therefore, it is important to foster the idea that college is a huge investment requiring savings in the manner in which one saves for a house or retirement. To help achieve this goal, many states, including

Pennsylvania, have expressed support for, have undertaken studies on, and have introduced bills to implement programs for tuition prepayment or incentive plans for savings for college.

I have introduced a bill to create a tuition prepayment plan for Pennsylvania. This bill is now being considered by the Pennsylvania Senate Education Committee. Along with my statement, I am submitting a brief analysis of this bill.

The implementation of Pennsylvania's proposed Tuition Account Program and similar programs and proposals under consideration by other states is contingent on obtaining a favorable ruling from the Internal Revenue Service concerning the income tax consequences for participants.

My proposal and others have been designed not only to provide security, certainty, and flexibility for participants, but also to improve the likelihood of receiving favorable tax consideration from the IRS.

Nevertheless, the tax issues involved are complex and, to date, the IRS has failed to rule on the tax consequences of participation in the tuition prepayment plan submitted by Michigan or plans submitted by other states.

Of course, the question of IRS approval would be moot if the Congress acts to make clear its intent to exempt from federal income tax any appreciation in value of tuition pre-purchased under Pennsylvania's Tuition Account Program or similar plans.

Such Congressional action would eliminate uncertainty about the viability of tuition pre-purchase plans and would signal our nations's resolve to give the same priority to facilitating and encouraging higher education opportunities for our citizens as we give to facilitating and encouraging home ownership and Individual Retirement Plans.

I thank the Committee for this opportunity to submit my views on the need for legislation to provide tax incentives for families and individuals planning for higher education expenses and I strongly urge the introduction and enactment of legislation that would exempt the appreciation of pre-purchased tuition from federal income tax.

ONE NEW YORK PLAZA
SUITE 2600
NEW YORK, N.Y. 10004-1980

(212) 820-8268

March 2, 1988

Senator Lloyd Bentsen, Chairman
Senate Finance Committee
c/o Laura Wilcox
Hearing Administrator
SD-205 Dirksen Office Building
Washington, D.C. 20510

RE: March 15, 1988 Hearing on Tax Incentives For Education

Dear Senator Bentsen:

I was pleased to learn that the Senate Finance Committee is holding a hearing on such an important issue. I would like to express the view that one of the simplest but most effective tax measures in this regard would be reinstatement of the personal income tax deduction for interest paid on student loans.

I find myself owing nearly $40,000 on student loans after pursuing both an undergraduate and a law school education. The interest rate on some of these loans is a high as 12%. It seems unfair to me that wealthier families are able to subsidize their children's education through the use of home equity loans, the interest on which is deductible, while families who have yet to participate in the "American Dream" of property ownership must resort to student loans, which saddle the student with high payments, the interest on which is being "grandfathered" out as a deduction. Moreover, as I know from my own experience, the burden of student loan payments renders even more remote achievement of the goal of property ownership.

Education is as much a part of the "American Dream" as owning one's own home. Educational loans, therefore, should receive at least as much support from the tax system as the traditional home mortgage loan -- the interest deduction for student loans should be reinstated.

Sincerely,

Harriet A. Robinson

Harriet A. Robinson

Telecommunications
Rockwell International Corporation
P.O. Box 10462
Dallas, Texas 75207-0462

Rockwell
International

The Honorable Lloyd M. Bentsen
U. S. Senate
703 Hart Senate Office Building
Washington, D. C. 20510

Dear Senator Bentsen:

Subject: Senate Finance Committee, March 15, 1988 Tax Incentives for Education
Extension for Section 127 - Tax Free Employee Education Assistance

With the Finance Committee actively looking for tax incentives for Education, I very much feel that the extension of Section 127, "Tax Free Employee Education Assistance" should be given first consideration.

I am writing to ask you to actively support the extension of Section 127 of the U. S. Tax Code providing Educational Assistance to employees.

The decision not to extend Section 127 of U. S. Tax Code has had a profoundly negative message from Congress. For example:

1. The job-relatedness test for excluding education aid from employee income tax represents a clear disincentive from the Federal Government to lower paid employees who wanted to achieve upward mobility and acquire new knowledge and skills to cope with changing workplace needs.

2. The same job-relatedness test amounted to a broad disincentive to the entire nation's work force for acquiring new job knowledge and skills ... at a time when a work force of the highest quality is essential for meeting the fierce and growing international economic competition. This is a key area where the dislocated worker who gets retrained under the new labor agreement in an auto and telecommunications industry will have to pay income tax on the value of retraining they receive.

3. It has been shown that reinstatement or extending the status would result in increased revenues, not revenue losses for the Federal Government, through increased taxes from the higher income of those who advance their economic status through more education and training.

4. The job-relatedness test itself causes extensive administrative confusion in interpretation.

A simple, permanent extension of Section 127 would be in the best interest of all. It would directly help those in the work force who want to advance themselves, and it would help improve the quality of the national work force.

Taxing employees for employer provided educational assistance appears to be inconsistent with the Federal Government encouraging more involvement of employers, less regulation, and more education and training for our work force.

I believe Section 127 helped develop a work force that has contributed to the bottom line increases. Rockwell International has over one hundred thousand employees and has invested millions of dollars in education and training. Patrick Crotty, Vice President Industrial Relations, Rockwell International has witnessed in support of this issue.

I would very much like to know your views on the matter and hope that you will work for permanent extension of Section 127.

Very Truly Yours,

Byron E. Gammage

Byron E. Gammage
Personnel Administrator
Rockwell International

THE ROCK ISLAND BANK
A member of The Service Banking Group.

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

The Quad Cities chapter of the American Institute of Banking (AIB) urges the Committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

Most Quad Cities' banks, including my employer, THE Rock Island Bank, encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employee education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

Approximately 20% (14 out of 70) of our bank's employees regularly enroll in classes offered through the Quad Cities Chapter of the American Institute of Banking. The offered educational courses prepare the employees for more sophisticated responsibilities in our company. The opportunities offered through the educational program often allow our employees to migrate from clerical wages of $4.00 per hour to supervisory wages of $6.00 per hour. The increased wages directly benefit the Federal Government through higher income tax and social security tax collections.

Unfortunately, hourly tuition rates at our local junior colleges in Illinois are rather high due to the lack of state funding as well as local depreciated property tax values. Discontinuing this critical tax incentive would just be one more additional deterrent to providing educational opportunities to promising workers.

THE Rock Island Bank is one of 30 Quad Cities area banks from Northwestern Illinois and Eastern Iowa actively participating in the Quad Cities chapter educational programs. Together, all of the banks sponsor over 300 enrollments per year in AIB classes offered through Scott Community College in Scott County, Iowa and Black Hawk College in Rock Island County, Illinois. Students pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Services, and Supervisory Skills.

You are urged to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

THE ROCK ISLAND BANK

John T. Kustes

John T. Kustes
Vice President and Cashier

Mary Russell
600 W. College Ave., #4
State College, Pa 16801

Dear Senate Committee on Finance,

My name is Mary Russell and I'm a graduate student at Penn State. I'm writing in regard to the effect the new tax laws will have on graduate students. I wish the contents of this letter to be put on record for the Senate hearing on tax incentatives for education.

Under the new tax laws, the dollar value of the remitted tuition that is part of my research assistantship will be added to my gross income, and I will pay taxes on this "source" of income in addition to the taxes I already pay on my stipend. Since Penn State's tuition is approximately $3500 a year, I will lose about $90 a month of income. This means my monthly net income will be $400 a month.

I don't want to sound ungrateful for the opportunity to attend graduate school, but $400 a month simply is not enough to live on. Necessities like food are very expensive, and despite my low income, I'm not eligible for food stamps. My rent is almost $300 a month. While I can certainly move to a less expensive place (I've already given my notice to my landlord), it is difficult to rent even a room in a house for less than $200 a month in State College. Other items like health insurance are very expensive. I pay $560 a year for a University sponsored insurance plan which provides very little coverage, but I'm not eligible for medical assistance for the bills this plan doesn't cover. My budget is already strained, and this doesn't include other expenses such as car insurance (which is mandatory in the state of Pennsylvania) and books and supplies. I'm not even eligible for student loans because I'm funded by the University.

I'm by no means alone in this situation. There are several others in my department, some in even more tenuous situations. While I think I can make it by reducing all non-essential expeditures, many students will be forced to sharply lower their standard of living, or take a part-time job which would sharply curtail time devoted to research and studies (the reason we are here), or perhaps leave the University.

Education is very important to the future of this country, not only for educating future researchers, but also for providing important government and industry research we are working on now as part of our assistantships. Tax burdens such as this can only result in a decrease in the number of students seeking advanced education. Is it worth risking America's technological edge in the world economy for the sake of a few tax dollars? We, as graduate students, are not trying to avoid paying taxes, nor are we asking for more money. What we wish is that our tax liability not be increased in this manner. We view our tuition remission as an important part of our financial aid that allows us to pursue our degrees, not taxable income. Please help us all by restoring tuition remission to tax free status.

Sincerely,

Mary Russell

Gregory G. Saulnier
1408 Pennsylvania Avenue
State College, PA 16801
(814) 863-0182

March 14, 1988

U.S. Senate Committee on Finance
U.S. Senate
Attn: Laura Wilcox
Hearing Administrator/ Tax Incentives for Education
Washington D.C. 20510

Dear Congressmen;

I am a graduate student at the Pennsylvania State University. As a research assistant seriously affected by the Tax Reform Act of 1986, I am concerned by new provisions of the Act that will take effect during the 1988 tax year.

Before this tax act took effect, my stipend was not taxed at all by the federal government, and as such it was also exempt from social security tax. In 1987, those taxes amounted to $1100. This is an $1100 loss for someone that makes $8800 per year. Now, the government wants to include my remitted tuition, the financial aid that makes it possible for me to attend Penn State, as a portion of my taxable income. This change in the law will increase my "earned income" by approximately $1000. As the taxes resulting from this additional "income" are about 25% of the remitted tuition value, Penn State will withhold more than $250 from my meager take home pay to meet this additional tax obligation. This added financial liability will make it impossible for me to continue in pursuit of my advanced degree.

My standard of living is already marginal. As it is, I can barely afford the Penn State student health insurance policy that has limited coverage and very limited benefits. The additional burden posed by the tuition tax are simply unacceptable.

Must we risk the scientific, technological, and educational future of our nation for a few additional tax dollars? The number of students from the United States willing to pursue higher degrees is already decreasing, can we afford to tax the others to extremes? In addition, is it possible that the government will begin considering other forms of financial aid needed by almost all students for higher education to be taxable?

Clearly, making advanced degree studies prohibitively expensive was not the purpose of the Tax Reform Act. I am asking for your support for the tax bill H.R. 1692 that eliminates the tax on tuition and also to introduce a bill to eliminate the tax on research assistantships. Swift, concerted action on your part will help to correct this disastrous tax on graduate tuition and stipends.

Thank you for your concern.

Sincerely,

Gregory Saulnier
Gregory G. Saulnier

Shawmut
Mortgage Corporation

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

As State Chairman of Ohio, American Institute of Banking and Director of Training and Development for Shawmut Mortgage Corporation I urge the Committee to report favorably Senator Daniel P. Moynihans bill, S39, which would restore permanently the IRC Section 127 exclusion for Employer - paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to restore this provision.

I have been involved in adult education and the American Institute of Banking since 1978. I presently am a part-time faculty member of two local universities, am a Certified Instructor of the National Association of Banking Women, am a Certified Instructor Trainer for the American Institute of Banking and consult and deliver adult education upon request throughout the United States. Adult education tuition reimbursement is one of the greatest employee incentives an employer has. It allows us a vehicle to maintain and improve employees current job skills and to provide further education that will qualify them for career advancement.

Most financial institutions encourage their employees to further their education by making use of Employee Education Assistance Programs. I am concerned that the expiration of the Employee Education Assistance Income Exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

As Director of Training and Development, Shawmut Mortgage Corporation and Chairman, State of Ohio American Institute of Banking, I urge you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for Employer - paid tuition assistance one of your top priorities for 1988.

Respectfully,

Deanne L. Mason
Deanne L. Mason
Director of Training & Development
State Chairman, Ohio A.I.B.

Security Bank

April 4, 1988

Honarable Lloyd Bentsen,
Chairman, Senate Committee of Finance
205 Dirkson, Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

As director of employee training for Security Bank, located in Marshalltown, Iowa, I would like to urge the Committee to report favorably to Senator Daniel P. Moynihan's bill, S39, which would restore permanently the IRC Section 127 exclusion for Employer-Paid Tuition Assistance which expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the work place. Much of this training will be lost if Congress fails to act to restore this provision.

Security Bank uses the continuing education programs offered by the Iowa Valley Chapter-American Institute of Banking and by Marshalltown Community College to supplement its in-house training program. By providing continuing education about the financial industry and financial products for our employees, we feel we are offering the financial consumers of this area increasingly better service because our employees are receiving current information and training.

We encourage participation in AIB through employee education systems programs. We are concerned that the expiration of the Employee Education Assistance Income Exclusion will discourage or prevent employees from seeking further education or new skills that will qualify them for career advancement and at the same time qualify them to better serve the needs of our banking customers.

Respectfully,

Janet Wills
Assistant Vice President &
Personnel Officer

JW/me

11 North First Avenue/Marshalltown, Iowa 50158/515-754-5500

WILLIAM L. DAVIS

Secretary/Treasurer

South Texas Higher Education authority

In 1976, Senator Lloyd M. Bentsen, Jr. of Texas sponsored an amendment to the federal tax code to permit duly constituted Higher Education Authorities sponsored by state and local governments to issue tax-exempt bonds for the purpose of financing loans for post secondary education made under the Federal Higher Education Act of 1965, as amended.

In announcing the beginning of operations for STHEA in September of 1977, Senator Bentsen made the following points about the Tax-exempt Bond approach to increasing access to student loans:

- We have opened the door of opportunity to the young people of South Texas who might otherwise have been denied the chance to attend college.
- We have provided new opportunity, new incentives - without raising taxes or creating a new federal program or creating a new government Bureaucracy.
- The program we have created doesn't consume tax revenue - it generates tax revenues.
    - There is immediate economic (and consequent tax revenue) impact (from expansion of educational services and consequent taxes paid).
    - There is additional future tax revenue (from individual income tax increases associated with raising levels of educational attainment).
- The program involves a new partnership between public and private sector resources.
- The program has succeeded in enlisting the active, dynamic support of the private sector behind the cause of educational opportunity.
- The program has made a federal program that wasn't working, successful in providing educational access.
- It is a flexible program responsive to the needs of people, not tied to the necessity for one-time or continuing government appropriation of funds -- the

Responding essentially to a local need for educational financing in South Texas, the concept embodied in the Bentsen Amendment became a model for the nation with 39 states, the District of Columbia and Puerto Rico having since implemented bond financed educational loan programs, under the Bentsen Amendment, as the means of providing access to higher education for students of primarily middle income families. Since inception in 1977, the South Texas Higher Education Authority ("STHEA") has, through secondary market purchases of loans from originating lenders, financed 46,341 loans to 25,736 students for attendance at more than 700 institutions of higher learning.

CURRENT ISSUES/QUESTIONS/POINTS

1. Why should tax-exempt financing continue to be available to state and local Authorities to finance educational loans? Are such Authorities still needed?

- The most basic reason for use of tax-exempt financing by state and local Authorities is that it is the sole source of permanent portfolio financing available at a cost that permits an Authority to cover the high costs of administration and servicing associated with student loans while yet accommodating the below market rate of interest that is provided under law for GSL borrowers.
- Short term taxable financings have been done by State and local Authorities but only on an interim stop-gap basis; not for long term permanent portfolio financing. Stand alone permanent taxable portfolio financing would only be economically feasible where the issuer could borrow at taxable rates approximating the rates at which the federal government borrows (or at which federal or quasi-federal agencies borrow via the Federal Finance Bank). Only the Student Loan Marketing Association (Salie Mae) which has been in existence since 1972, has had access to credit support from the Federal Finance Bank; State and local issuers do not.
- The Student Loan Bond Program is designed not for all students but to accommodate the special needs of students of middle income families who do not qualify for low income grants and who do not earn enough to pay today's costs of higher education. The Guaranteed Student Loan Program (GSL) under Federal Higher Education Act is the primary source of potential assistance available to middle income families. GSL loans however, are predominantly made by commercial lenders. Experience has shown that such lenders will not, in many areas throughout the nation, meet the demand for GSL loans unless they are supported by a viable state or local secondary market. The Student Loan Bond program was designed to accommodate unmet need -- need that commercial lenders otherwise would not fill, and on a secondary market basis, need that other secondary markets do not fill.
- It should be noted that not all states (only 39) have developed such programs and even within these states, the state or local bond issuing Authority doesn't necessarily finance or re-finance all loans made within that state. In South Texas, the South Texas Higher Education Authority finances only about 13% of the total resident student population.
- The primary function of a Higher Education Authority is to meet (or provide incentives to commercial lenders to meet) the needs of an area for student loans that otherwise would not be met. Not all lenders desire or require access to a secondary market for student loans.
- Some lenders desire to originate and hold student loans through repayment and therefore do not need any form of secondary market.
- Some lenders desire to originate and hold loans until the repayment period begins and then sell their portfolios under the best possible terms and conditions;

some of these sell to the federally sponsored Student Loan Marketing Assocation rather than to state and local Higher Education Authorities.

- o But some lenders have previously experienced difficulty with the national secondary market and will only deal with a state or local Authority.

- o In the absence of the State and local secondary markets, lenders that do require secondary market support would be faced with the possibility of only one choice -- a monopolistic national purchaser -- as was the case before the Student Loan Bond Authority program was made possible by the Bentsen Amendment. The fact that the program has been so successful is the best possible evidence that it is serving a genuine need that wasn't and otherwise most likely would not have been met.

- o Another alternative would be to have no secondary market (either federally sponsored thru Sallie Mae, or operated at the State and local levels through Higher Education Authorities. Past experience has clearly demonstrated that effective secondary markets are an essential incentive to needed private sector participation in meeting the educational financing needs of America under the Guaranteed Student Loan Program. This is true from a lender standpoint because (1) student loans have no collateral unless made under the GSL program, (2) the GSL program restricts the interest rate that may be charged to below market rates (3) servicing and collection of GSL loans is costly and complex under existing and constantly changing program regulations and (4) cost in relation to return (i.e. spread) cannot be effectively controlled by the lender; which disincentives are substantially alleviated by participation in a State or local Higher Education Authority program.

- o Given federal budget pressures there is a growing shift from grants to loans, even at the low income levels, as a means of meeting the educational financing needs of the nation; consequently the need and demand for educational loans is increasing both as to number of students financed and in term of dollars per student required to meet increasing costs of education. Thus the need for educational loans and the financing capabilities of Higher Authorities rather than decreasing, is increasing.

- o State and local Authorities provide the opportunity for local Boards of Directors to design programs around the unique or special needs by their respective local areas.

2. Why do Student Loan Bond issuers need to retain investment earning (i.e. income from temporary investments in "Non-Purpose" obligations) when other types of issuers are required to rebate?

- o One of the essential elements of the Bond Financed student loan program is that it provides, through the secondary market take-out process, an incentive to lenders to originate student loans. Many lenders will simply not originate loans for future sale if firm commitments are not in place to assure that once the loans have been originated, they will be purchased on the secondary market. Consequently, Bonds must be issued to provide funds for the future purchase of loans from originating lenders. There can be no absolute assurance however that (1) lenders will actually originate loans (i.e. changing laws, regulations, etc.) or (2) that loans originated will actually be sold (i.e. changing policies of the lender due to cyclical economic trends, etc.). Thus, if in fact loans are not acquired and the only income received by the issuer during the temporary permitted "bond use period" (i.e. income from temporary investment of funds in "Non-purpose" obligations) is required to be rebated, the amount of funds available to pay Bonds would be less (by the amount of costs of issuing and interim operating expenses incurred) than the amount of Bonds outstanding. The possibility of this occurring is the basis for the bond rating agencies refusal to grant a rating (which is as a practical matter necessary to the sale of bonds in the nation's capital markets) on bonds that could be destined, solely by virtue of regulation, to default.

o Student Loan Bond Authorities, have no other source (such as governmental appropriations or taxing power) from which to pay these costs. Income from temporary investment of net bond proceeds in "non-purpose" obligations, pending conversion of funds to loans and subsequent income from loans, are the only sources of recovering these costs of Higher Education Authorities.

o Student Loan Bonds constitute only a very small segment of the total volume of tax-exempt financing, amounting to only approximately $1.7 Billion in 1986, and consequently, Student Loan Bonds represent only a very small portion of any tax subsidy attributed to tax-exempt financing by states and local issuers.

o A recent study commissioned by several Higher Education Authorities (see attached) suggests that full rebate of "Arbitrage" profits on student loan bond issues would only yield between $8.8 million and $10.6 million to the federal Treasury. It is doubtful that a federally administered direct student loan program (which would necessarily be supported by new Congressional Appropriations) of approximately $1.7 Billion annually could be administered for what amounts to six tenths of one percent ($10,600,000 + $1,700,000,000 = 0.00624%).

3. Why do Tax-Exempt Student Loan Bond issuers need a "Bond Use" Period longer than other types of issuers?

o Unlike construction projects financed with Bond proceeds, the student loan program is a continuing program in which loans are made over a period of time subsequent to the issuance of the bonds. In most cases, substantially all of the proceeds of an issue are required to be expended to acquire or make loans originated after the delivery date of the Bonds with certain limited exceptions (i.e. loans made in anticipation of bond issuance, consolidation loans for prior borrowers, etc.). Thus a period of time is required in order for loans to be originated and subsequently purchased.

o Lenders participating in secondary market programs will not generally "gear up" to originate loans on a one-time basis. Additionally, their student customers expect that if a loan is made to them for one year that the lender will also make loans for the school years that follow. The normal term is of course four years for the standard undergraduate college degree program. Thus, lenders will not commit resources (i.e. employ personnel, commit office space and supporting resources, etc.) to lend for only one school year while borrowers likewise expect the lender (and the lender consequently expects the secondary market) to be able to provide a multi-year financing commitment. As indicated previously, a future purchase commitment is the essential incentive that causes lenders to be willing to make student loans where they otherwise would not.

- In terms of the efficiency of Bond issuance (i.e. Cost of Issuance and administration), larger issues (i.e. covering multiple years of financing requirements are more cost efficient than a series of small issues amounting to the same aggregate amount of net Bond proceeds because of the fixed cost and sliding fee schedules for necessary legal and investment banking services, etc. in connection with bond issuance.

4. Why is the traditional "Permitted Yield Spread" approach to controlling "Arbitrage" not working appropriate to Student Loan Bonds?

- The "permitted yield spread" approach to controlling "Arbitrage" assumes that all issuer's programs are the same and their cost structures are the same when such is not the case. There is significant variance in the cost of loan servicing, among the various State and local programs. Portfolios weighted towards comparatively high average borrower indebtedness will cost less to service than portfolios of equal size comprised of lower average indebtedness. Some issuers incur higher cost, Illinois for example, because the issuer concentrates its purchase activities on acquiring for collection those loans that are in delinquent status. Whether loans are acquired soon after origination or after the "in-school period" and just prior to the beginning of the "repayment period" will significantly affect the issuer's potential spread.

- The life of a particular student loan portfolio financed with bond proceeds may extend over a 15 to 17 year time span and unlike a utility project in which the project sponsor can increase or decrease revenue rates to fit future events, the revenues of Student Loan Bond issuers, but not necessarily the expenses, are fixed at the beginning of the issue when loans are acquired.

- For the foregoing reasons, no one single "permitted yield spread" rate is appropriate to all Student Loan Bond issues if the objective is to permit the issuer to finance but not be able to accumulate "Arbitrage Profit". The result of the single permitted yield spread rate is that some issuers may not be able to finance because the permitted yield spread would be too small, while other issuers could potentially exceed the permitted "Arbitrage" accumulation -- issuers and the government under this scenario, receive either too much or to little.

- What is needed is an alternative that does not hinder an Authority's efforts to finance but which accomplishes the government's objective of preventing unnecessary accumulation of "Arbitrage" profits by restricting Student Loan Bond programs to that which is needed in order for them to accomplish their purpose and no more. Student Loan Bond Issuers stand ready to assist the committee to develop such alternatives and we believe there are means of accomplishing this objective.

5. Why should Tax-exempt Student Loan Bond issuers have either a separate cap allocation or be subject to an alternative means of volume control?

o Financing should be available at the time educational expenses are required to be paid by the student and as an extension, Higher Education Authorities should not be prevented from financing (either directly or on the secondary market) when funds are needed, solely because of the timing of available cap allocations.

o In Texas, by February 16th, the State's total Cap Allocation for Private Activity Bonds for 1988 had been fully utilized. (The South Texas Higher Education Authority which presently needs new funds is therefore unable to finance.) It is understood that some Student Loan Bond issuers in other states (Nellie Mae in Massachusetts, for example) have never been able to receive a Cap Allocation while in yet other states, the full Cap Allocation has never been fully utilized. The Cap Allocation system, as presently in effect, therefore does not treat (in so far as access to available educational financing) a student in one state, all other things being equal, the same as students of another state.

o At present college facilities are exempt from the Volume Cap but not the student themselves.

6. Why should Tax Exempt Student Loan Bond issuers be permitted to finance Supplemental Loans (i.e. loans not made under the Federal Higher Education Act)?

o "Supplemental Loans", unlike GSL loans would involve no direct appropriated subsidy by the federal government (i.e. no interest or Special Allowance subsidy).

o The existing GSL program limits (maximum of $4,000 per year at the undergraduate level and $7,5000 per year at the graduate and professional level) are inadequate to meet the needs of borrowers in attendance at some state schools and those who desire to attend most private non-profit schools.

o Today's GSL program income eligibility restrictions (i.e. family income generally less than $30,000 adjusted gross) which was considered "middle income" a decade ago translates into approximately $57,000 in 19875 Thus, the GSL program is increasingly restricted to students of low income families and today's middle income student is again, as in 1976 when the Bentsen Amendment was passed by Congress, increasingly faced with reduced opportunity to access financing for higher education.

ATTACHMENT 1

EXCERTS FROM
COMMENTS BY SENATOR LLOYD M. BENTSEN, JR

September 19, 1977
San Antonio, Texas

Consider for a moment what we have done.

The South Texas Higher Education Authority, created by COSTEP, has successfully marketed over $20 million in tax-exempt bonds and it has made $20 million in student loans available to the young people of South Texas. Our program is unique in the Nation. This is the first time its been done. Just remember you saw it first in South Texas. We have established a precedent of success that is going to be copied across this nation.

We have opened the door of opportunity to over 7,000 young people of South Texas, who might otherwise have been denied the chance to attend college.

Lets take a look at what is happening to education in our country today. If you are very poor in this country and you have a talented child you want to send to college, it's no problem.

But for that great group in the middle, if you have one, to two, or three you're trying to send to college, its tough!

A college education is slipping out of the grasp of the middle income people of America. Now here is a positive, affirmative step to correct it.

COSTEP had the foresight to appreciate that talented middle income students were being overlooked and being denied a college education.

These people understood that the majority of South Texans are neither very rich nor very poor. They are middle income families, earning between 10 and 30 thousand dollars a year, frequently with several children. And they were caught in that squeeze play of inflation and the cost of a college education. They were confronted with the ending of that dream of seeing that their children have a step up in life by that college education.

True, there was a federal program that was supposed to help.

But a federal program that was covered with a lot of red tape and regulations; that had income limitations on it, that made it exceedingly difficult for middle income people to qualify.

Well, here's a chance for them to borrow the money and pay it back - a loan program that provides up to 10 years after school to repay at low interest rates - a change for them to help finance that education.

COSTEP, through the South Texas Higher Education Authority found an effective, inexpensive answer to that difficult problem. By the simple expedient of establishing an immediate and assured secondary market for Federally Insured Student Loans, we have made 7,000 young people from our region eligible for college. We have given 7,000 young people the means, to continue their education and to acquire the skills that will enable them to bootstrap their way up the ladder of success. And in the process we have generated substantial economic activity for South Texas.

The people of South Texas, on their own initiative and using their own resources, cut the Gordian knot of the Federal Student Loan Program.

And that's precisely the sort of effort that we ought to be encouraging across this nation today. The strength of our country has always been its freedom. Not just its political freedom, but the freedom to succeed with a new and better idea.

Our system of economic incentives has traditionally acted as a spur to private enterprise and accomplishment. It has created a dynamic, expensive economic system and generated the capital to make it grow.

Today our progress is stifled by some of the highest taxes in the world, an alarming sense of dependence on big government, a tendency toward regulation and control, and tons of federal paperwork and forms to be filled out in triplicate. We just have to break this cycle of reliance and dependence, and COSTEP has shown that we can.

The key to solving problems in America is the active involvement of the private sector. Whether we are dealing with South Texas or national issues, we must exhaust the ways of encouraging private decisions to be made for the public benefit.

I fight this problem almost every day in the Finance Committee. When I talk about a tax incentive, they say, "Now isn't that a tax loop hole? Isn't that a tax expenditure?" I said, "No, if you want to call it a tax expenditure, then you have to come to the conclusion that all income belongs to the government."

But, I don't happen to think that. I think that the carpenter that nails a plank to a wall, or a teacher who helps mold the mind of a child, has created income, their income, that they give up part of that income at their sufferance to the government to accomplish the objectives of the society.

I think it is better to give an incentive to the private sector to compete over, if that's the most effective and the most efficient way. That's why I've fought to see that these were tax-exempt bonds, that we would be able to sell to fund the education of these young people.

It is important to remember that we the people, were the catalyst for COSTEP. We realized that we had problems of low income, lack of development, employment, and affordable educational opportunity in South Texas.

We set out to find a solution, and were able to enlist the support of the Department of Commerce and the U.S. Office of Education. But we didn't ask them to do all of our work for us.

We amended the federal tax laws to make sure that we were on firm legal ground. And we worked with the IRS and other government agencies.

Then we turned to the Texas State Legislature for amendment of the higher education code. We needed the cooperation of the Commissioners Courts in 58 Texas Counties, and we got it. We needed the support of the five Regional Councils of Government in South Texas, and we got it. Eleven City Councils in this area adopted ordinances supporting our program.

And then we went to the private sector. We offered a better idea to the 265 banks of South Texas, and I think they are going to buy it. We offered an incentive - the missing ingredient in many federal programs. Then banks were receptive, and so were the 28 institutions of higher learning in that area.

We didn't ask the government to purchase our bonds. We sold them through the private market mechanism.

COSTEP tied it all together. It has woven a remarkable fabric of cooperation that extends, on the government level, from Washington, D.C. through Austin, to the municipalities of South Texas, and to the private sector. We brought the banks on board to help design it, the schools and the universities, and we took advantage of the dynamics of the market place.

I think of few programs with which I have been associated that give me more pride and hope as the accomplishments of this organization. We have brought the talent and energy of the private sector into productive association with the resources of government, and that's really a potent combination, with infinite potential for accomplishment. And that's the way this country ought to be run.

A CHAPTER OF EXCELLENCE

Southeast Arkansas Chapter
American Institute of Banking

March 29, 1988

The Honorable Lloyd Bentsen, Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

RE: Comments submitted for hearing on Tax Incentives for Education

Dear Mr. Chairman:

The Southeast Arkansas Chapter of the American Institute of Banking (AIB) urges the Committee to report favorably Senator Daniel P. Moynihan's bill, S 39, which would restore permanently the IRC Section 127 exclusion for employer-paid tuition assistance. Section 127 expired on December 31, 1987. Mr. Chairman, this exclusion is a critical tax incentive that promotes continuing education and retraining in the workplace. Much of this training will be lost if Congress fails to act to restore this provision.

Southeast Arkansas AIB has always depended on user pay as our whole means of support. A decline in the number of students in classes would be a burden on our chapter financially.

Today, AIB is the largest educational division of the American Bankers Association. Four hundred chapters enroll 350,000 persons each year in education and training programs. Admission to AIB is available to employees, officers and directors of banks. While many AIB students enroll in order to maintain or improve their current job skills, the majority of students come to further their education or learn new skills that will qualify them for career advancement.

By participating in AIB programs, students have the opportunity to pursue professional diplomas and training certificates in a number of areas, including: General Banking, Consumer Credit, Commercial Lending, Mortgage Lending, Customer Service, Securities Services, Supervisory Skills, and Accelerated Banking Study.

Most Banks encourage participation in AIB through employee education assistance programs. We are concerned that the expiration of the employees education assistance income exclusion will discourage or prevent employees from seeking further education or new skills that would qualify them for career advancement.

The Southeast Arkansas chapter of the American Institute of Banking urges you to make passage of legislation to reinstate permanently the IRC Section 127 exclusion for employer-paid tuition assistance one of your top priorities for 1988.

Respectfully,

Wanda Smurl
President

THE STATE TEACHERS
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STAFF COUNSEL CYNTHIA E HVIZDOS

April 8, 1988

Laura Wilcox
Hearing Administrator
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Ms. Wilcox:

On behalf of the State Teachers Retirement System of Ohio Board of Trustees and members, I am writing to express our deep concerns about the expiration of the Educational Assistance Programs exclusion under Section 127 of the Internal Revenue Code which results in tuition reimbursement now being covered under Section 162 of the IRS Code.

Our concerns are summarized as follows:

1. The loss of the annual exclusion discriminates most heavily against the less well-trained, lower skilled, and lower paid work force. Contrary to Treasury Department testimony, national statistics collected by the American Society for Training and Development indicate that 70% of the training through tuition reimbursement goes to employees earning $30,000 or less, and 30% goes to those earning $15,000 or less.

   The 30% group is particularly significant because in most instances, they simply cannot afford the additional tax burden. Also, at a time when, as a society, we are concerned about improving the productivity of adults who are illiterate, unemployed, or underemployed, elimination of the exclusion flies in the face of many national programs addressing the problems of the undereducated and unskilled. To now force these employees to pay taxes on tuition reimbursement is just not sound public policy.

   As another example of the negative effects of the loss of exclusion, consider the impact on the teaching profession. Public school teachers, in particular, are among the nation's lowest paid employees. Current policy is particularly discriminating against the people who have the responsibility of educating the bulk of our nation's youth.

2. In our state, employees are also faced with a higher state income tax liability because taxable income at the state level is tied directly to taxable income for federal purposes. In other words, to use laymen's language, employees receive a double whammy.

3. The shift to Section 162 rules also places increased burdens on employees in the determination of non-deductible versus deductible expenses. If the reimbursement is included on the employee's Form W-2 as wages, the employee will be able to deduct the payments only to the extent that his or her miscellaneous itemized deductions exceed 2 percent of adjusted gross income. It is unlikely that most employees would have miscellaneous itemized deductions of that magnitude.

At a time when the skills of our work force in relation to competing in an international economy are a national concern, implementing public policy which is counter to encouraging training, particularly for those people who need it most, is a tragic step backward when the economy can least afford it.

Finally, it is our understanding that the Treasury Department has testified that the exclusion policy was not a fair benefit because not all workers received tuition reimbursement. Treasury referred to the issue as a matter of horizontal equity. Does this mean that deductions for dependent children should now be excluded because not all families can have children? Certainly in this context, single persons are harshly discriminated against as well. Horizontal equity appears to be applied by Treasury only when convenient.

We strongly believe that the former exclusion process is sound public policy and should be reinstated immediately. Any loss of revenue will be more than offset by continued growth in human productivity, which is our single most important national asset.

Sincerely,

James Miller

James W. Miller
Director of Governmental Relations

JWM/pw

SPECIAL REPORT

TAX ANALYSTS

SAVING FOR COLLEGE EXPENSES WITHOUT TAXES

by Richard L. Kaplan

Richard L. Kaplan is a professor in the College of Law at the University of Illinois at Urbana-Champaign.

In this article, Kaplan discusses the Administration's proposals to restrict the use of income-shifting arrangements. Kaplan points out that these arrangements are commonly used by middle-income families to provide for college expenses. He suggests modifications in the Administration's reform plan that would permit income-shifting arrangements for educational purposes. Alternatively, if income-shifting arrangements are to be curbed, he suggests that the Administration revive its proposal for tax-deferred educational savings accounts (ESAs).

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As scrutiny of President Reagan's tax reform plan continues, the controversy surrounding deductibility of state and local tax payments has all but obscured another proposal that would affect many of the same taxpayers.

Hidden among the 461 pages of the May 29 missive, in a section entitled "Tax Abuses—Income Shifting," is a plan to tax at a parent's marginal rate the income earned by a child on property originally received from that parent. For example, if a parent buys a corporate bond and transfers the bond to his or her child, the interest payments are to be taxed as if the parent still owned the bond. This seemingly straightforward proposal would largely vitiate all of the tax planning devices commonly employed to help fund a child's college education.

Financial planning guidebooks regularly suggest shifting passive income such as interest, dividends, and royalties to one's children, who presumably are in lower tax brackets than their parents. So-called Clifford trusts, spousal remainder trusts, and Uniform Gifts to Minors Act (UGMA) transfers are among the standard, low-cost arrangements designed for this purpose. These arrangements require the parent making the transfer to relinquish ownership of the transferred property for a period of time, sometimes forever, as in the case of UGMA transfers. In any case, the *earnings* on the property derived during the period of the transfer become the property of the recipient permanently. Accordingly, these mechanisms are best suited to benefit those who are the natural objects of one's bounty—namely, one's children.

Although the use of trusts may conjure up visions of exceptional, "old" wealth, the arrangements described above are principally the province of middle-income families, including those trying to send their first generation to college. Major banks like Citibank accept trust accounts of $10,000, and local banks frequently have much lower minimums. Brokerage firms, in fact, regularly establish UGMA accounts with no required minimum balance. These arrangements, incidentally, are very inexpensive to establish and maintain, requiring only minimal legal expenses and other transaction costs.

Although income-shifting is not restricted to any particular purpose, the overwhelming majority of such plans accumulate funds to help meet the ever-rising costs of higher education. In fact, many of the commercially available standard plans are set up with this objective, and only this objective, in mind. Yet, the President's reform proposals eliminate, with narrow exceptions, the tax advantages that have been accorded these plans for over 50 years.

The Administration may believe that its plan to lower tax rates generally will eliminate the appeal of income-shifting, but that belief is wrong. A 35 percent tax rate may not be as onerous as a 50 percent rate (even when applied to a more-inclusive taxable base), but it is nevertheless more onerous than the lowest proposed tax rate, 15 percent, and much more onerous than a zero tax rate. Indeed, increasing the personal exemption to $2,000 per child allows a child to earn even more income than before without incurring the first dollar of tax. To go a step further, even if a *single* tax rate were applied to all income, as has been occasionally suggested, the presence of any significant personal exemption (and the single-rate proposals exempt at least $5,000) continues the attractiveness of income shifting. Thus, the Administration's attack on trusts and UGMA transfers cannot be justified on the basis of their anticipated obsolescence.

Revenue loss to the government is obviously another issue, but all deductions and exclusions suffer that problem. Besides, there are ways to control revenue losses. In lieu of the current lack of any dollar restrictions, the tax code could limit the amount deposited in a Clifford-type trust or a UGMA account to a specified sum per child per

It is time for the Administration to dust off its educational savings account proposal . . . and press for its approval.

year. Further, the Code could restrict such arrangements to funding a child's college education, thereby limiting still further the amounts parents would be willing to commit to these accounts. Either restriction could significantly decrease the revenue loss suffered by the government while still enabling middle-income families to realize their children's educational aspirations.

ESAs as an Alternative

Ironically enough, these alternatives resemble a proposal made by this very same Administration only two years ago—the Educational Savings Account (ESA). In concept, the ESA is similar to the increasingly popular Individual Retirement Account, or IRA. Funds would be set aside for a child's education and could be used for that purpose only. During the accumulation period, the earnings would not be taxed to the parents, thereby providing the major tax benefit of this mechanism. Revenue losses to the government could be modified by making the initial contributions non-deductible (unlike the IRA, but similar to existing trusts and UGMA transfers), or by limiting to a specified sum or a percentage of income the amount a parent may contribute. The variations are endless, but the point remains that revenue losses could be controlled short of eliminating educational savings plans entirely.

The President's reform proposals eliminate... the tax advantages that have been accorded these plans for over 50 years.

The possibilities for adjusting these variables are nowhere better illustrated than in the President's tax package itself. The President's proposals make IRAs even more attractive than they are now by increasing the allowable maximum contribution. There are, of course, economic policy reasons supporting this proposal, which are applicable to ESAs as well. For example, restricted savings plans such as IRAs (or ESAs) tend to increase per capita savings, channel funds into long-term investments, and thereby augment capital formation. Similarly, such arrangements enable citizens to provide for their own needs, decreasing demands for publicly provided assistance. Just as IRAs are expected to ease the pressure on public retirement programs, particularly Social Security, so too could ESAs be expected to ease the pressure for public assistance to higher education. Because the Administration is trying to cut back government expenditures for educational grants and loans, the ESA concept merits very serious attention at this time.

Interestingly enough, when the ESA concept first surfaced a few years back, a major drawback to its adoption was competition from Clifford trusts, UGMA accounts, and the like. If these latter arrangements are effectively eliminated, as the President's plan provides, the ESA will become even more vital than originally conceived.

Moreover, there are sound policy reasons supporting the substitution of ESAs for trust-type arrangements. First, ESAs could be limited to funding educational needs, unlike unrestricted trusts, which may be used to provide European vacations, late-model cars, and similar baubles. Second, by adjusting the contribution parameters, the government can limit the size of the subsidy it wishes to bestow and restrict the number of beneficiaries. Thus, the ESA could be targeted specifically to those taxpayers currently receiving the least amount of tax relief under the President's proposals—families earning between $30,000 and $100,000 annually.

Because the Administration is trying to cut back government expenditures for educational grants and loans, the ESA concept merits very serious attention at this time.

Third, the ESA would be blissfully immune from attack by the Internal Revenue Service, unlike the trust-type arrangements. The Service often argues that state law requires a parent to provide his children with a college education—akin, if you will, to food and shelter—and that funds provided by the trust, or whatever other mechanism, are relieving the parent from his legal obligations. Accordingly, those funds should be taxed to the parent, the Service reasons. Because parental support laws vary from state to state and rarely settle this problem with any reliable specificity, substantial uncertainty often accompanies traditional income-shifting arrangements. The ESA, in contrast, would be specifically sanctioned by Congress and impervious, therefore, to IRS attack.

Conclusion

It is time for the Administration to dust off its educational savings account proposal of the very recent past and press for its approval. Most families have two major long-term savings objectives: college education for their children and retirement for themselves. This Administration has been the principal champion of helping working Americans with the latter objective by making IRAs broadly available in 1981 and proposing their expansion today. It is entirely appropriate that this Administration also begin helping middle-income taxpayers with their other major objective, educating their children. Only in so doing can it realistically hope to reduce direct educational assistance, such as grants and loans. At the same time, it will provide a sense of balance in its tax reform proposals for those taxpayers in the middle of our earnings curve.

TAX NOTES TODAY*, OUR DAILY ELECTRONIC TAX MAGAZINE, IS AVAILABLE THROUGH *NEWSNET, LEXIS, WESTLAW* AND *THE SOURCE

Tax Notes Today provides comprehensive daily coverage of all federal tax developments, including the full texts of all IRS regulations, and Tax Court decisions. This daily electronic edition is the quickest, easiest way to keep up with the daily changes in tax law and tax policy. For more information about *Tax Notes Today*, call Lucia Smeal at (800) 336-0439. (In Washington, D.C. area, call 532-1850)

PROGRAM ANALYSIS
SENATE BILL 333, PRINTER'S NO. 1791

Senate Bill 333, Printer's No. 1791, provides for a prepaid tuition program--the Tuition Account Program--with the following provisions:

The Tuition Account Program (TAP) allows families and students to pre-purchase units of tuition for future use.

Tuition credits purchased are usable by any eligible beneficiary at any institution of higher education which participates in the program. Eligible beneficiaries include residents of Pennsylvania or persons who attend Pennsylvania colleges and universities. Participating institutions include the community colleges, State-owned universities and State-related universities of the Commonwealth, plus any private institutions (both within and outside of Pennsylvania) which choose to participate in the program.

Since students may not have selected a college or university at the time tuition credits are purchased, the program provides five standard tuition levels to assist purchasers in targeting their needs: community colleges, State-owned universities, State-related universities, lower-cost private colleges in Pennsylvania, and higher-cost private colleges in Pennsylvania. Tuition credits purchased at any of these standard levels are converted for use at the specific institution attended by a student, by adjusting the number purchased in accordance with relative cost levels at the time of each tuition purchase.

At the time of a student's enrollment the Tuition Account Program Agency (Agency) will pay the participating institution, on behalf of the student, the lesser of the guaranteed tuition or actual tuition corresponding to the adjusted tuition credits in the purchaser's account. Guaranteed tuition is calculated by compounding each total annual purchase of tuition credits from the year of purchase to the year of use, by the average annual constant maturity yield on 10-year U.S. Government Securities, as computed by the U.S. Treasury Department, and summing.

If a purchaser's account is terminated because of the death or disability of a beneficiary, or because a beneficiary has failed to gain admission to a participating institution within a reasonable time, the purchaser is due a refund from the Agency, calculated by compounding each purchase from the date of purchase to the date of termination, at the actual net earnings rate of the TAP fund, and summing. In all other cases (including the use of prepaid tuition at nonparticipating institutions), the refund is only the sum of payments made by the purchaser.

The purchase, retention and use of tuition credits are made exempt from State and local income taxes. However, the Act creating TAP is automatically repealed if a favorable IRS ruling concerning the federal income tax consequences for purchasers is not received within 18 months of enactment.

Tektronix
COMMITTED TO EXCELLENCE

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April 8, 1988

The Honorable Lloyd Bentsen
Chairman
Senate Finance Committee
SD-205 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Chairman Bentsen:

Tektronix, Inc. strongly supports restoration of Section 127 of the Internal Revenue Code which excludes from taxation employer-reimbursed educational assistance, regardless of whether that reimbursement is job-related.

These have been difficult times for Tektronix, which remains one of the world's largest manufacturers of electronic design and measurement tools used by scientists, engineers and technicians. With sales staying flat at roughly $1.3 billion for more than five years, Tektronix has experienced workforce reductions and other cutbacks. In the face of a $6 million loss last quarter, Tektronix reduced our workforce further, sold two businesses and lopped off expenses. Yet, at the same time, we made the affirmative decision to retain our employe educational assistance program.

"While we realize this represents an additional expense to our employes [Tektronix is a profit-share company], Tek continues its longstanding commitment to employe education by continuing to finance the bulk of education expenses," said Phil Robinson, vice president for administration.

In 1986-87, Tektronix employes enrolled in 8,000 courses for which they were reimbursed. In 1987-88 the number of course enrollments which were reimbursed jumped to 10,000. Tektronix invested $1,244,636 last year in employe educational assistance.

As a result, Tektronix has literally hundreds of examples of men and women who have taken classes while working here and improved their skills, making them eligible for job advancement or giving them the freedom to move into whole new fields with greater opportunities.

Elimination of the tax exclusion contained in Section 127 works the greatest hardship on people on the bottom of the economic ladder. The nature of their jobs limits what qualifies for job-related educational assistance. Because they are the lowest-paid employes, they are the most sensitive to an increase in cost for educational improvement. For many, the increased cost is enough to dissuade them from taking a course, from trying to improve. They lose, but more important, the nation loses.

As we enter a period when skilled workforce shortages are widely predicted, we cannot afford as a country to waste any of our human resources. Investments in people are easily the most important and highly leveraged economic decisions we can make to capitalize on the opportunities laying before us in the Information Age. It is a great irony that in an age characterized by increased automation, the role of each individual worker has become more important. The success of the worker is determined, directly and almost without exception, by the level of skills they possess. With rapid change accelerating, even the most skilled worker can fall behind if he or she fails to keep pace through continuing education.

We can sympathize with the situation that Congress finds itself in trying to match incoming revenues with outgoing expenditures. We appreciate the pressure on Congressional tax-writing committees in these circumstances. However, we cannot afford to pursue penny-wise, pound-foolish strategies. Taxing our workers for employer-reimbursed educational assistance will produce a dribble of revenue, but it also could withhold a flood of change in individuals on whom the country will increasingly depend for its economic competitiveness and its national security.

We have watched this modest benefit work inside Tektronix. We are convinced that we get back more than we invest, and thus have decided to keep making these educational investments in our own people even amid our own fiscal crunch. We hope you will, too.

Thank you for considering our views and including them as part of the hearing record on whether to restore Section 127 to the IRC.

With warm regards,

Sincerely,

GARY L. CONKLING
Director Public Affairs

Tri-Cities University Center

March 14, 1988

Ms. Laura Wilcox
Hearing Administrator
SD-205 Dirksen Office Building
Washington, D. C. 20510

Dear Ms. Wilcox:

Due to the recent closure and possible closure of two major projects on the Department of Energy Hanford Site (Basalt Waste Isolation Project and the N-Reactor) the Tri-Cities area is facing major work force reductions and the retraining of remaining employees in DOE Hanford Contractor organizations. This reduction and retraining also filters down to small businesses throughout the Tri-Cities.

The effect of the expiration of EEA will have a significant repercussion to area businesses and to Hanford employees who must be retrained in order to continue their employment.

One of the components of diversification plans to aid the economy for the Tri-Cities area is to establish a branch campus of Washington State University. The expiration of EEA will affect the impact of the Branch Campus in stimulating the economy, and assist in retraining employees in this area.

I urge you to extend Section 127, tax-free Employee Educational Assistance.

Sincerely,

Twila Cooper

Twila Cooper
Assistant Director
Continuing Education

TC/sn

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U.S. CHAMBER OF COMMERCE
by
Robert L. Martin* and
Karen A. Berg**
March 15, 1988

I. INTRODUCTION

The U.S. Chamber of Commerce appreciates the opportunity to present its views on tax incentives for education: specifically, the extension of employee educational-assistance programs, reinstatement of the tax deductibility of interest on student loans, and other proposed educational funding mechanisms. The Chamber is committed to the goal of making high quality education available to all segments of the population. The economic well-being of American business is tied directly to the educational attainment of our citizenry. Further, current international competitive pressures suggest that a thorough review of national budget and tax policy is appropriate and timely if we are to meet this country's future human resource needs.

Accordingly, the Chamber supports the permanent extension of Section 127 of the Internal Revenue Code (employee educational-assistance), and reinstatement of the tax deductibility of interest on student loans. It also urges Congressional review of tax-free savings bonds, educational savings accounts, and educational trust funds targeted to assist Americans in financing educational costs.

The Chamber has a long-standing interest in ensuring that all Americans have access to high quality public and private educational resources. A well-educated work force is this country's greatest asset. The private sector has a responsibility to ensure the availability of high quality education and training programs for current and future workers.

On January 25, 1988, the Chamber announced the availability of new private-sector funds for financing public and private education. The program, ConSern: Loans for Education, makes funds for financing educational expenses available to employees of all Chamber members. Covered expenses for employees and their families can include tuition, fees, books, room and board, computers, laboratory supplies, and transportation.

The ConSern program does not establish income criteria but uses credit-worthiness as the eligibility standard. ConSern loans feature high loan limits, long repayment terms, and low interest rates.

The Chamber has a long-standing concern for the availability and affordability of higher-education programs. ConSern is designed to assist Chamber members in meeting the educational needs of their employees.

II. EMPLOYEE EDUCATIONAL ASSISTANCE AND THE ROLE OF SECTION 127

In 1978, employee educational-assistance programs became tax-exempt through the creation of Section 127 of the Internal Revenue Code. Section 127 was established to provide increased educational and economic opportunities for employees by excluding from gross income the value of employer-provided educational assistance. The Tax Reform Act of 1986 extended Section 127 through December 31, 1987. Unfortunately, the tax-exemption lapsed when this section was not extended beyond that date.

Recent studies indicate that Section 127 has played an important role in meeting the training and educational needs of the American work force. According to a 1985 survey conducted by the American Society for Training and Development (ASTD), 97 percent of all respondents operated educational-assistance programs; 96 percent of their employees were eligible to participate; and 72 percent of the participants earned less than $30,000 per year. In fact, employees making less than $15,000 per year participated at twice the rate of higher-paid employees. Also, small- and medium-size organizations made the greatest use of educational-assistance programs -- 14 percent of respondents reported less than 500 employees, and 91 percent cited local community colleges as the primary provider of related courses.

The ASTD survey clearly indicates the following trends:

- Educational-assistance benefits are offered by a broad and diverse cross section of employers.
- Section 127 provisions are used by employees at different compensation levels, with the highest concentration in the low-to-middle-income range.
- Section 127 allows employers to offer cost-effective programs for upgrading the skills of employees.
- Educational-assistance programs encourage workers (and employers) to keep up with new technology and industrial developments.

These conclusions were reinforced by the findings of the Chamber's Survey Center. Employee Benefits (1986) revealed that more than 75 percent of all firms provided employee educational-assistance benefits in 1986, an increase from 69 percent in 1985, and more than double the 37 percent 15 years ago. Further, all major industry groupings provide this benefit. Educational assistance is more prevalent in the faster growing services sector, in which 79 percent of the firms reported providing this benefit. The manufacturing sector reported that 70 percent of the firms provided this benefit but also reported greater expenditures per employee than services firms.

In summary, employee educational assistance is one of the fastest growing benefits offered by employers. This assistance benefits both the employer and the employee. If current trends continue, coupled with the ever-increasing demand for trained employees, this benefit could become as common as health insurance.

III. NEED FOR REINSTATEMENT OF SECTION 127

The current absence of Section 127 requires employers to revert to the "job relatedness" test in order to provide tax-free education and training assistance. This four-part test to insure tax-free status requires that the education: (1) must either maintain or improve skills needed by the employee for current job responsibilities or meet the employer's express requirements for retaining a job; (2) must not qualify the employee for a new trade or business; (3) must not be needed to satisfy the minimum educational requirements of the employee's job; and, (4) must be provided under a plan that allows only "job-related" educational aid.

Not only are these IRS rules complex and confusing, but also they are contradictory. For example, two accountants work in the tax department of the same company; the company suggests that they take tax courses that will help them with their jobs and offers to reimburse their tuition costs. Accountant A takes the tax courses at a business school; his expenses are probably job-related and nontaxable (i.e., exempt from federal taxes). Accountant B takes the tax courses at a night law school. If the courses taken by Accountant B can be applied to a law degree, his expenses are probably taxable -- since they may qualify him for a new profession. However, if the law school is unaccredited, his expenses are nontaxable.

In another case, two secretaries take the same word-processing course; but because of small differences in their jobs, one's expenses may be taxable, while the other's is not. A receptionist's expenses for taking the same course as the secretaries almost certainly would be taxable. Clearly, this situation is not beneficial to either the employer or employee and should be reconciled.

The urgency of reinstating this provision was underscored by Secretary of Labor Ann McLaughlin on the occasion of the 75th Anniversary of the Department of Labor:

> We also must expand and improve education and training for experienced workers. As we move into the next century, our work force will be aging at the same time that changing technology and changing markets will require adaptable workers with flexible skills. Whether it is called retraining or continuing education, on-going programs need to be established to help workers learn new skills and retool old ones . . . .

The Chamber believes that Congress should reinstate permanently Section 127 of the Internal Revenue Code. Permanent extension of this valuable tax incentive would allow employers and employees to plan their educational goals more effectively and would avoid troublesome delays caused by the lapsing authorization process.

IV REINSTATEMENT OF THE DEDUCTION FOR INTEREST ON STUDENT LOANS

Under the Tax Reform Act of 1986, the deduction for interest on consumer loans, including student loans, is being phased out over five years. Educational loan recipients preparing their 1987 tax returns may deduct only 65 percent of the interest paid on their loans. By 1991, the deduction will be eliminated.

Congress justified the repeal of this deduction on the grounds that it is a disincentive to savings. But in the face of rapidly escalating higher-education costs, many American families are finding it difficult, if not impossible, to save enough to educate their children.

Since 1980, the cost of an undergraduate or graduate degree has increased by nearly 75 percent -- about twice the rate of inflation. An increasing number of students are relying on educational loans to meet higher-education expenses. More than 4.5 million students receive educational loans through federal government programs; countless others secure loans in the private sector. In total, public and private loan programs provide 49.4 percent of student assistance.

Interest on loans secured by a primary or secondary residence and used for educational expenses remains deductible. But this does not help those who do not own their own homes -- primarily lower-income taxpayers -- or those who lack sufficient equity in their homes. It is estimated that nearly 40 percent of all Americans fit into this category. Clearly, this is an unfair situation.

Reinstatement of the deduction for interest on educational loans would make the tax code fairer for Americans who must borrow to meet higher-education expenses. Further, it would help to make education more affordable and, thus, open more opportunities for individuals as we approach the 21st century. The Chamber calls on Congress to reinstate this important tax deduction.

V. OTHER EDUCATION FINANCING PROPOSALS

A variety of educational tax and savings incentive proposals has been introduced in the 100th Congress. The Chamber currently is undertaking a comprehensive review of all educational funding mechanisms. Among them:

1) Tax-free Savings Bonds. Interest earned on U.S. savings bonds and used to pay for higher-education expenses would not be taxed. Many companies currently encourage employees to purchase savings bonds through payroll deductions. This could give employees easy access to a savings program, with no applications to complete or investment choices to make. Similar proposals call for the creation of special education savings bonds. President Reagan, in his 1988 State of the Union message to Congress, expressed support for tax-free college savings bonds.

2) Educational Savings Accounts. These accounts -- similar to individual retirement accounts (IRAs) -- would allow families to contribute a certain amount each year solely for the purpose of financing higher education. Contributions up to a set limit would be deductible from gross income. Similar proposals would make contributions to such accounts tax exempt as long as the funds are used for higher education. Finally, other proposals would allow penalty-free deductions from IRAs to pay for higher-education costs.

3) Educational Trust Funds. Parents could invest in a fund that would pay a portion of future tuition and other related educational costs directly to a postsecondary educational institution. Contributions would be tax-deductible.

The Chamber urges Congress and the Reagan Administration to begin a thorough review of educational-funding options. If we are to meet the human resource needs facing this nation, we must begin to evaluate all potential solutions.

IV. CONCLUSION

A well-educated work force is vital if the United States is to compete effectively in the international marketplace. The workplace demands of the future will require employees and employers to retool, reeducate, and retrain at an increasingly accelerated pace. It also will require developing new strategies that better coordinate budget and tax policy with projected human resource needs. A first step in developing such strategies is the reinstatement of federal tax incentives for education (i.e., Section 127 and interest deductibility for student loans).

Finally, we must continue to foster alliances that link educational efforts to economic development and to improve productivity through the availability of effective and efficient education and training programs. For that reason, a thoughtful and programmatic review of other funding options, by both private and public organizations, is needed. For its part, the Chamber will continue to stress the need for innovative private-sector approaches (e.g., ConSern) to meeting these needs, while calling for changes in existing fiscal policies.

The Chamber commends this Committee and its Chairman for addressing these important issues and holding the recent hearings on this topic.

UNITED STATES ACTIVITIES BOARD
THE INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS INC

The United States Activities Board (USAB) of the Institute of Electrical and Electronics Engineers (IEEE) strongly urges support of permanent, retroactive reinstatement of Section 127 of the Internal Revenue Code, which expired December 31, 1987.

IEEE is the world's largest technical professional organizaton with more than 290,000 members in over 130 countries, including 235,000 in the United States. The Institute encompasses 36 Societies and Councils in virtually all areas of electrotechnology, including aerospace, computers, communications, biomedicine, electric power, and consumer electronics. The United States Activities Board of IEEE was established in 1973 to evaluate the professional, economic, and sociotechnical concerns of the membership and, when appropriate, to convey these concerns to the public, to industry, and to the US government.

IEEE/USAB is confident that the members of the Senate Finance Committee are well aware of the need to provide incentives for the employees of business and industry to keep abreast of the latest technologies. Only with highly skilled workers will the United States be able to maintain (and in some cases regain) a competitive edge in the world, take commercial advantage of new technologies, avoid unemployment caused by technical obsolescence, and improve the quality of life of its citizens.

If new technologies are to be utilized commercially, workers must be able to move from one project to another. This requires lifelong learning, often in new areas of expertise, and it applies not only to graduate engineers but to the technologists and other workers who support them. For electrical, electronics, and computer engineers, specifically, it is necessary to enhance and renew technical competence regularly, given the rapid progress being made in all fields of technology.

Because alternative means (e.g., tax credits, vouchers) of providing incentives for employees of business and industry to pursue continuing education have not yet been legislated, IEEE/USAB feels that retroactive reinstatement of Section 127 of the Internal Revenue Code is imperative. A hiatus of even a year or two without these incentives will result in further loss of the country's already tenuous grasp on world leadership in science and technology by throwing a pall on engineers' educational activities. This loss of momentum in individual educational programs will be difficult to recapture.

IEEE/USAB is confident that the Senate Finance Committee will recognize the potential costs of not reinstating Section 127. The loss of revenue that will result from the reinstatement cannot be compared to the far more serious and lasting blow that will be dealt the US work force over the long term. IEEE/USAB agrees with many companies that lifelong education is a legitimate cost of doing business which should not be viewed as a fringe benefit. We urge Congress to look at it in the same way.

Sincerely yours,

Edward C. Bertnolli

Edward C. Bertnolli
IEEE Vice President
Professional Activities
and Chairman
United States Activities Board